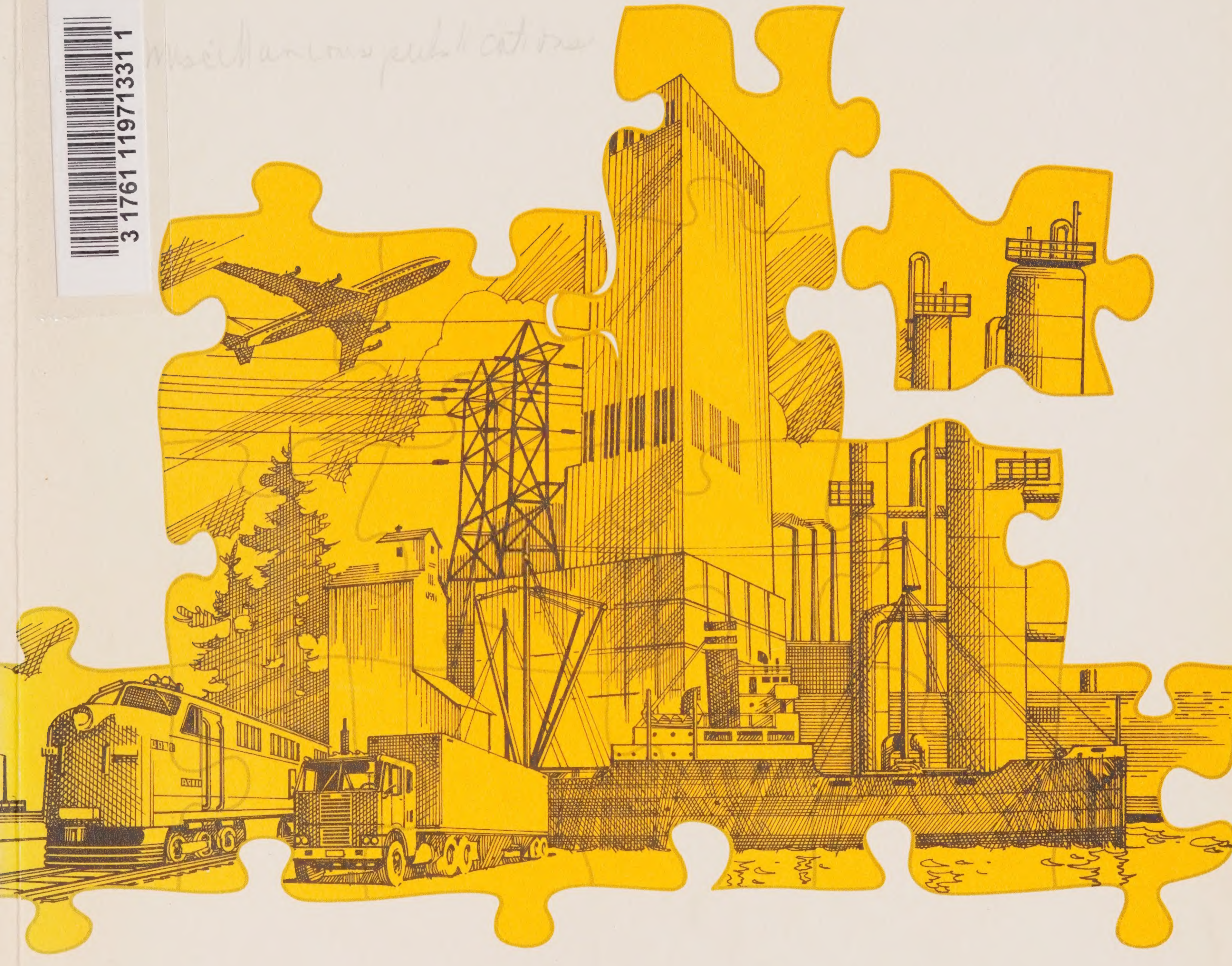
Royal Commission on Corporate Concentration



STUDY NO. 18

Corporate Disclosure

A Background Report

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by

John A. Kazanjian

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FOREWORD

In April 1975, the Royal Commission of Corporate Concentration was appointed to "inquire into, report upon, and make recommendations concerning:

(a) the nature and role of major concentrations of corporate power in Canada;

(b) the economic and social implications for the public interest of such concentrations; and

(c) whether safeguards exist or may be required to protect the public interest in the presence of such concentrations".

To gather informed opinion, the Commission invited briefs from interested persons and organizations and held hearings across Canada beginning in November 1975. In addition, the Commission organized a number of research projects relevant to its inquiry.

The study on corporate disclosure was prepared as a discussion paper for the Commission by John A. Kazanjian. During the Commission's deliberations of the question of disclosure, an earlier draft of the paper was distributed to about 150 individuals, institutions and corporations for their comments.

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The Commission is publishing this and other background studies in the public interest. We emphasize, however, that the analyses presented and conclusions reached are those of the author, and do not necessarily reflect the views of the Commission or its staff.

Donald N. Thompson
Director of Research

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INTRODUCTION

The modern corporation is the most effective and powerful private institution within industrialized society. From the turn of the century it has demonstrated an unexcelled ability to withstand and adapt to political and economic changes while sustaining ever increasing rates of growth. Yet there are many who would contend that no institution can amass power and preserve legitimacy in a society predicated upon democratic values if it does not satisfy some test of accountability. In turn, all tests of corporate accountability presuppose a need for corporate information; for there can be no measure of accountability without relevant data. To reverse the proposition, every claim for corporate information can be understood in terms of a claim for corporate accountability.

Until recently, much of the pressure for public disclosure arose within the context of shareholder protection and securities regulation. The owners and potential owners of corporate capital stood in a proprietary relationship to the company and thereby provided a tangible line of interest along which accountability and information could flow.

Two significant trends, however, have recently materialized which have created the impetus for substantial changes in the content and character of demands for corporate information. The first is a product of the ubiquitous growth and concentration of corporate power which is perceived as having an increasing impact on the lives of more and more individuals. In an effort to channel and direct that impact, the public responds by attempting to influence corporate behaviour. In order to do so, they require more information.

The second trend involves the decentralization of demands for corporate accountability from government to members of the public. For the last forty years, government has been the primary user of corporate information which it acquired in order to regulate or administer those activities where public and private ends were perceived to diverge. Corporations were not accountable to the public directly, but indirectly through government, and therefore it was to government alone that information had to be relayed.

Where corporate power and corporate planning now outpace many of the state's regulatory mechanisms, and where many of the traditionally indirect modes of accountability, via government to the public, are often costly and unsuccessful, a crisis of confidence in both public and private institutions tends to manifest itself, with individuals left no recourse but to independently assert their self-interested demands for accountability.

It is perhaps this factor which in part explains the proliferation of public interest groups seeking information about cleaner air or safer products. Under such circumstances, information becomes the only substitute for confidence, and disclosure, the only means by which trust in the efficacy of our private and public institutions might be restored.

The following chapters present an analysis of the existing requirements for disclosure in this country and in the United States. They include observations on the properties of corporate information and on the probable benefits and costs which might be encountered in any scheme of expanded disclosure. The paper does not deal with that very large body of corporate information which is disclosed to government but not to the public. That issue, however, is canvassed briefly in the Appendix, for there is a unique relationship between the government's secrecy about its own operations and the scope of corporate disclosure.

1. AN ANALYSIS OF THE PRESENT REQUIREMENTS FOR CORPORATE DISCLOSURE

There are many different channels through which corporate information is communicated to the public. Perhaps the most common is commercial advertising, whereby corporations voluntarily offer information about themselves and their products. Media investigations and reporting in the financial press are examples of other avenues. By far the most corporate information is transmitted in these ways and with little government interference. If there is state intervention, it arises in such form as the proscription of misleading advertising, which focuses on the accuracy and reliability of the information flow but does not require any particular data to be supplied.

There are however, other channels of the corporate information flow where government does impose an affirmative obligation on companies to provide the public with information. Truth-in-lending statutes are one example; insider trading and prospectus provisions in provincial Securities Acts and others. In such instances, government might function as a clearinghouse, collecting data in a central registry to which the public is given access; or, it might specify that the companies distribute the information, or that they permit public access to their records. Whatever procedure is used, the effect is to compel the disclosure of corporate information for one or more of four possible purposes: to identify companies, to deter objectionable conduct, to focus political opinion or to assist in private decision-making.

IDENTIFICATION AND CLASSIFICATION

Where the public is given access to records that contain essentially descriptive and noncontroversial data such as the corporate name, head office address, date and jurisdiction of incorporation and the names and addresses of directors and officers, the purpose being served is primarily one of identification. Those dealing with the company, and creditors in particular, are able to use the information to verify descriptions, to glimpse at those behind the corporate veil and to facilitate communication with the firm.

The provincial Corporate Information Acts deal with this type of disclosure and generally require that all corporations carrying on business within the jurisdiction submit returns annually. This information is placed in a central registry, and upon payment of a nominal prescribed fee any member of the public will be given a certified copy of the filed document. Any company that fails to file a return or that makes a false or misleading statement is subject to penalty. In Ontario, the annual return procedure has been replaced by a system of initial notices with new filings required only when changes occur in the information on file.[1]

At the federal level, the Canada Corporations Act,[2] section 133 and the Canada Business Corporations Act,[3] section 256 require that all federally incorporated companies file an annual summary containing much the same information demanded by the provincial statutes.[4] The data are kept in a central registry in Ottawa and members of the public are permitted to inspect and obtain copies upon payment of the proper fee.

A further federal statute, the Corporations and Labour Unions Returns Act (CALURA)[5] in part A compels the disclosure of identifying data which is then made available to the public; but it is not restricted in scope to federally incorporated companies. Any corporation, wherever incorporated, carrying on business in Canada whose gross revenues exceed $500,000 or whose assets in Canada exceed $250,000 must submit an annual return setting out, among other things: its name, head office address, the general nature of its business, the date and method of incorporation, the names and addresses of directors, its share structure, the countries in which shareholders reside, the identity of major corporate shareholders, the identity of subsidiaries and the classes of issued and outstanding capital debt. Exempt from having to respond are banks, insurance companies and regulated firms in the transportation and communication industries, all of which submit comprehensive but confidential returns under other statutes.

Having identifying data in a central register also serves a classifying need of the respective governments, as several provinces employ the system to avoid corporate name problems. By far the most sophisticated use of this type of information is being implemented in Quebec where the provincial Department of Financial Institutions, Companies and Co-operatives is compiling "The Central File of Business Enterprises".[6] Every company carrying on business in the province is assigned a number under which all the administrative data solicited by the various government departments and agencies will eventually be recorded. The identifying information received under The Quebec Companies Information Act[7] forms the skeleton or backbone of each file.

It should be noted, however, that the Quebec statute differs from the Ontario and federal acts in two material respects. First, it is not a general disclosure statute. There is no provision for public access to the central file, but companies are required to make a copy of the return available to creditors and shareholders at their head office. Secondly, the disclosure of identifying data is much broader than either the Ontario or federal statutes and includes: the identity of primary lines of business according to the Standard Industrial Classification Code, the location and value of real estate held in the province, and the name of the chief officer within the province.

Under Part A of CALURA or under the Ontario Corporate Information Act the disclosure of identifying data is rarely an issue in the debate over corporate accountability. The kind of information is too general, too fundamental for that.[8] On the other hand, the mechanisms established to collect and manage identifying data can not be overlooked in any regime of expanded disclosure. Central registries, computerized and accessed to the public, are in place at both federal and provincial levels; and as the new program in Quebec indicates, identifying information, in addition to any specific use which might be made of it, can form the backbone of a scheme for the assembly and potential disclosure of more significant kinds of data.

DETERRENCE

The public disclosure of corporate information can deter questionable or unpopular business practices--an effect most clearly expostulated in the oft-quoted phrase of Mr. Justice Brandeis:

> "Sunlight is said to be the best of disinfectants; electric light the most effective policeman."[9]

This view is predicated upon the existence of a standard of corporate behaviour from which any departure is subject to sanction. In support of the standard, an obligation is imposed to provide information that would reveal noncompliance. The disclosure thus deters potential offenders because it facilitates enforcement and creates the apprehension that detection and therefore sanction are unavoidable. As the following analysis indicates, the operation and success of the approach differs, however, depending on whether the primary standard is legislated or is simply derived from popular sentiment.

An example of the former, namely disclosure as a legal deterrent, can be seen in the regulation of insider trading. Rather than instituting costly administrative measures, or resorting to a blunt criminal proscription of all insider trades, the Canada Business Corporations Act, the provincial Securities Act and the United States Securities Exchange Act[10] all employ a pattern of civil liability and mandatory disclosure to prevent corporate insiders such as directors, officers and ten-per cent shareholders from using their advanced access to inside information to profitably trade in their company's securities.

Section 125(5) of the Canada Business Corporations Act imposes civil liability in stating that insiders are accountable to any person suffering a direct loss in a transaction in which use has been made of specific confidential information. Insiders are also liable to the corporation for any profit made from the improper trade. By sections 124(1) and (2), short sales and the purchase of puts and calls by insiders are illegal. The anonymity of the stock market would make the detection impropriety governed by sections 124 or 125 extremely difficult were it not for sections 122 and 123 which require insiders to disclose their

initial holdings and to report all subsequent transactions to the Director of Companies, who then publishes the information in a periodical that is available to the public. Thus any insider engaging in an improper trade must choose between two undesirable alternatives--he may file an insider report, which would expose him to sections 124 and 125 liability, or he may refuse to file, which is itself a summary conviction offence independent of any other wrongdoing.

Although the example is instructive as a legislative model, insider trading laws technically relate not to corporate accountability, but the accountability of directors and officers. With the exception of securities prospectus disclosures, which are thought to have deterred corporations from making fraudulent offers of securities to the public, there are in fact few examples where public disclosure has been used as an enforcement mechanism and deterrent for corporate violations of a legislated standard.

Rather than granting enforcement powers to the public by imposing a pattern of civil liability supported by the obligation to disclose, government generally has chosen several other methods of controlling corporate behaviour--from direct regulation to criminal sanction. It is not within the scope of this work to comment on the efficacy of that approach nor to consider the consequences of expanding civil liability. What is significant, however, is that the deterrent qualities of public disclosure are indeed questionable where the public lacks the legal capacity to act on the information.

This leads to the more complex and much more significant question involving the deterrent effects of disclosure where a standard of behaviour is one of moral prescription or popular sentiment rather than one ordained by law. What effect might one expect from a law which imposed no primary duty, but which required disclosure and then relied on informed public pressure to enforce an unlegislated popular standard? Would those comtemplating a breach be sufficiently deterred without the further threat of legal sanction? The answers depend on the extent to which corporations regard themselves as accountable to the pressure group and to the interests which it represents.

In one sense, this begs the classic question of corporate responsibility, namely, "to whom are corporations accountable?" The debate has provided a broad range of answers. At one extreme are those who contend that corporations should consider the interests of, among others, employees, consumers, minority groups and the environment. At the other extreme are those who assert that corporations should single-mindedly pursue a goal of maximizing profits for their shareholders. Current opinion rests somewhere in between the two extremes, yet for the sake of analyzing their significance for a disclosure policy more light can be shed by examining the poles.

For the proponents of the latter view, disclosure would have little deterrent effect unless it could be shown that public knowledge of a company's noncompliance with some moral standard would have an adverse impact on its profits or share values. Taking that impact at its narrowest, one might find some neoclassical economists who would contend that because sales, and therefore profits, could be impaired only where the disclosure was related to price or product quality, the only elements in a "rational" buying decision, the disclosure of any other data would be pointless.

Few, however, would contend that all buying decisions were "rational". A familiar case of publicity interacting with "irrational" buying decisions occurred in the continent-wide boycott of California grapes, not on account of their price or quality, but because growers were allegedly engaged in unfair labour practices.

Although one may not be able to formulate a disclosure policy based on unpredictable or economically "irrational" public response, an argument can be made that share values reflect every aspect of corporate activity and not just what appears on the most recent profit statement. The shareholder's interest is thus equated with a course of corporate conduct which does nothing to jeopardize long run profit maximization, and in some instances that will entail the abandonment of morally unpopular activities. In the United States, shareholders in the famous Medical Committee case[11] ultimately were seeking to have the management of Dow Chemical discontinue the production and sale of napalm because it produced little profit while impairing the company's public relations and employee recruitment efforts.

While legislators in Canada have not recognized the relationship between controversial corporate activity and share values in formulating disclosure requirements, that is not true of the United States, where the Securities and Exchange Commission has, for example, requested the disclosure of information which sets out the effects that compliance with environmental legislation will have on a company's capital expenditures, earnings and competitive position.[12] The SEC has also been considering the disclosure of environmental impact statements and details on the extent of political contributions and payoffs to foreign government officials. Arguably, such information relates to the future security of the investment and is reflected in share values.[13] For example the recent disclosures of commissions paid to foreign officials by Lockheed Aircraft in the United States have apparently damaged the company's foreign sales and in fact caused the Canadian government to review a one-billion-dollar supply contract with the firm.

The deterrent value of disclosure which depends on the shareholders' interest in long run profit maximization to invoke sanction may be questionable, for few corporate activities are so easily identifiable as a cause of impending decline or so controversial

as to cause shareholders, acting in their self interest, to take action. Moreover, in spite of the Medical Committee case and the growing popularity of "shareholder democracy"[14] there is the compelling argument first formulated by Berle and Means in 1932 that shareholder control in the modern corporation is mythical.[15] Actual control resides in corporate management. The number of shares and the breadth of their distribution in most major corporations are so great that any individual shareholder who is dissatisfied with the company's behaviour would likely sell his shares rather than contemplate the invocation of internal corporate mechanisms to alter that behaviour.

Moreover, large private companies whose sole shareholder is a foreign corporate parent could not be deterred by disclosure except indirectly by the response of shareholders of the foreign parent corporation, most of whom would not be aware of the situation because of their distance from Canada.

If the above view of corporate responsibility leaves little room for disclosure as an effective deterrent, what of the other view of corporate responsibility, the one that maintained that corporations perceive themselves as morally accountable to employees, consumers, minority groups and others? From this perspective, responsibility is said to flow, not from a concern with profits and shareholder reaction, but from a recognition that the exercise of corporate power should be subject to the influence of those whom it affects. It thus follows that disclosure should be an effective deterrent because companies would be reluctant to stray from an ethical standard of behaviour knowing that their actions would be open to public view.[16]

Upon analysis, however, there are very serious problems presented by this approach. As one attempts to project the potential for disclosure-induced deterrence beyond self-interested shareholders into broader settings, several factors inject uncertainties between anticipated ends and actual results. Shareholder influence, or whatever remains of it after Berle and Means' analysis, is effective because there is a cohesive and easily identified pressure group; a convenient forum exists in the proxy vote and shareholder's meeting for the exercise of influence; there is a pre-existing legal duty owed to shareholders based on a property right; and the desired course of conduct is often clearly intelligible and easily understood by the corporation.

Few, if any, of these conditions apply to the exertion of pressure by other interest groups. There are no suitable mechanisms through which corporate activity might be influenced. Instead of the narrow and democratic forum of proxy solicitations and shareholders' meetings, one must look to the large and uncertain arenas of the marketplace or the political process.

In the United States, public interest groups have avoided the problem by gaining access to shareholder control mechanisms for the price of a share.[17] Assuming, however, that the avenue of becoming a shareholder is not attempted, then in looking to the wider forums mentioned above, the efforts of those seeking to alter corporate behaviour become diluted within the pool of other forces at work on corporate decision-making. The breadth of the market-place, for example, and the numbers who inhabit it also work against the possibility of common agreement being reached on sufficiently precise ethical standards by groups large enough to make their presence felt.

Despite these shortcomings, there is one way in which disclosure supported by this rationale could function as an effective moral deterrent. Modern corporations, and in particular those with large market shares, devote considerable time and money to the cultivation and projection of a favourable public image. Upon that image rests future sales, the ability to recruit talented personnel and the prestige of management. The disclosure of a discrepancy between public image and private reality would pose the risk of losing these benefits and would thereby induce the company to pursue conformity with its projected image.[18] Employing this rationale, public interest groups in the United States have petitioned the SEC to require the disclosure of supporting information on minority employment practices by all companies which make public claims about such matters.[19]

This issue is perhaps more closely related to the control of misleading advertising than it is to corporate disclosure. It does, however, highlight one important fact, and that is that disclosure is unlikely to have any deterrent impact unless it triggers the possibility of sanction. As the preceding discussion indicated, such sanction may take several forms, but in general all ultimately rely upon the visitation of some economic loss upon the corporation. Disclosure which merely invokes moral approbation is not sufficient, for an entity with an unlimited existence has no concern with the hereafter.[20]

One further note is necessary. The use of disclosure as a moral deterrent may not be socially desirable. Government has the authority to pass into law any commonly accepted moral rule. Beyond that, we tolerate not one but a plurality of ethical standards. To promote corporate adherence to the most popular or the most vociferously advocated conceptions of morality could court misfortune through the widespread "moralization" of large private power centres.

Although much would depend on the kind of information that would be disclosed, it is possible to conceive of situations where companies could be pressured into accommodating popular sentiments which might offend against an employee's or supplier's right to political or religious freedom. A blacklist, for example,

is predicated on information. Neither can one escape the probability that in its extreme limits; any process which promotes the use of moral coercion as a sanction must encompass economic reprisals and group boycott, activities which one may hesitate to encourage.[21]

A FOCUS FOR POLITICAL OPINION

The most noticeable limitation on the use of disclosure as a deterrent is the absence of mechansims through which corporations are directly accountable to the public. An indirect line of accountability, however, does flow through government where, in theory at least, the supervision of corporate activities is entrusted to the appointees of a legislature politically responsible to the public. That fact in itself may prove an effective deterrent, for most corporations do not want further direct government regulation. One might thus consider instituting a regime of disclosure which relied for its sanction on the threat that the outcry by an informed public would lead to more restrictive direct regulatory measures. Disclosures could thus break ground as an intermediate method of influencing corporate activity leaving companies more freedom to operate than they would have under other regulatory schemes and reducing the need for more costly administrative intervention.

Disclosure could also have a salutary effect on public confidence and might restore the damaged credibility of the corporate sector. Ignorance breeds suspicion and creates a fertile environment for the fashionable revelation of one "corporate sin" after another. If the reputation of sinner is undeserved, one might question the corporate antipathy to disclosure; for implicit within the public's suspicion may be Bentham's comment on the right to remain silent:

> "Innocence never takes advantage of it: innocence claims the right of speaking, as guilt invokes the privilege of silence."[22]

Reflecting this sentiment, several corporations in the United States have voluntarily conveyed information in order to dispel undeserved public suspicions. One instance as recounted by Kenneth Axelson involved a large retail chain.[23]

> Up until a few years ago, retailers made no disclosures concerning the profitability of their customer credit operations. It was well known that credit was enormously profitable and that many retailers broke even on the sale of merchandise and made all their money in credit. In view of this it wasn't really surprising to find that a number of states initiated legislation to reduce the maximum rate of service charge on credit accounts.

> In the Penney Company we had been losing money on credit ever since we started the activity in 1958 and these reductions in rates were unbearable. We concluded that a major part of the problem was with ourselves--the retailers--who for years had been secretive about the results of credit operations. We, therefore, decided to present this information in our annual report and asked our auditors to cover this data in their opinion.
>
> The first reaction to this dislcosure was that we were not telling the truth because 'everyone knows how much money retailers make on credit'. But when additional retailers and other credit grantors adopted a similar disclosure practice and had their auditors attest to the operating results, the public began to recognize that the profitability of retail credit was, in fact, a myth.

INFORMED PRIVATE DECISION-MAKING

The deterrence of illegal or unpopular corporate behaviour is a secondary purpose of most disclosure legislation. The primary object is to facilitate sound decision-making by the recipients of the information. To the extent that our economic and political systems depend on a process of personal choice and private decision-making, it is essential that there be knowledge of the relevant facts upon which decisions are to be based. In this context, affirmative disclosure is but one process among many--commercial advertising and press reporting being others--which supply corporate information to the decision-making public.

It is, however, somewhat misleading to speak of the "decision-making public" because that expression implies a homogeneity of interest, and disguises the actual conglomerate character of what is referred to as "the public".[24] With respect to its use of corporate information, "the public" is not a unitary body but consists of a multitude of private interest holders, each intent upon using information in a way which best furthers his own ends. A company's shareholders, suppliers, competitors and consumers are all members of the public whose decision-making depends on corporate information, although few will be interested in the same kinds of information and none will respond to it in the same way. The disclosure, for instance, of large profits might cause employees to demand higher wages, potential competitors to enter the market, investors to purchase shares, and might leave many consumers indifferent.

Given this variety of interest, the legislative decision to require the disclosure of a particular item of corporate information implicitly legitimates the decision-making needs of some private interests but not others. Applying this analysis

to the existing requirements for corporate disclosure, it is fair to conclude that the information needs of the capital market have received the preponderance of legislative recognition in Canada. The primary recipients of disclosed data are shareholders and investors, and even though there is a trend to expand the scope of access to include other elements of the public, the very character of the information, essentially describing the company in financial accounting terms, remains more congenial to shareholder and investor interests than to any others.

This capital market focus can be attributed to a number of factors, from the present state of accounting practices to the government's preference for alternate regulatory methods to protect other interest holders, all of which will be examined later; but the most important reason, quite simply, is that certain conditions exist in the securities market which make disclosure a particularly effective aid to private decision-making. It is therefore necessary to analyze the existing disclosure provisions for investors and shareholders not only to explain the present state of the law, but to determine the conditions which make disclosure such an effective device in this context.

Disclosure for Investors and Shareholders

The legislative authority to order disclosure to investors and shareholders is constitutionally divided between the federal and provincial governments. Although the matter is under further study the federal government, unlike its United States counterpart, does not exercise power over securities regulation and investor protection; and therefore, relying on its general incorporating authority, only imposes disclosure requirements on federally incorporated companies.[25] The provincial governments not only exercise power over companies incorporated pursuant to their own incorporating authority but also occupy the field of securities regulation which enables them to compel disclosure from companies, wherever incorporated, that offer securities to the public. This legislative framework is the opposite of that found in the United States where there is no federal power to incorporate companies but a very strong federal presence in securities regulation entrusted to the Securities and Exchange Commission.[26]

United States Securities Regulation

The United States Securities and Exchange Commission's forty year experience with disclosure as a method of investor protection has so inspired Canadian legislation that its examination is essential as an introduction to securities regulation in this country.[27] Following the stock market's Great Crash, the United States enacted the Securities Act of 1933[28] and the Securities Exchange Act of 1934.[29] The former statute requires that the

initial distributions of most corporate securities be registered with the SEC. A registration statement has to be filed setting out the registrant's properties and business, a description of the securities, details concerning corporate management and certified financial statements; and a prospectus summarizing the information must be given to the buyer. The SEC has no authority to pass on the merits of any issue; its role is to ensure that the information is sufficiently accurate and complete for prospective purchasers to independently evaluate the merits of the investment. False or misleading statements and omissions attract both civil and criminal liability.

The 1934 Act is directed to the secondary market or the post-distribution trading of securities through the stock exchanges and in the over-the-counter market. Companies wishing to have their securities listed for public trading through an exchange must file a registration statement similar to the one required for initial distributions under the 1933 Act and thereafter must file periodic and annual returns in order that the information remains current.

Disclosure is comprehensive. For example, the annual return, Form 10-K, requires among other things a description of the company's principal products and services, its competitive position, principal customers, the source and nature of raw materials used, the extent of its compliance with environmental legislation, research expenditures, foreign operations, pending legal proceedings, properties, the number of employees, its sales and income on a line of business basis, its relationship to parent and subsidiary corporations, changes in outstanding equity securities, and information about management together with detailed financial statements certified by an independent accountant. There are additional disclosure requirements with respect to proxy solicitations and take-over bids and an obligation to make timely disclosure of material corporate developments as they arise. Although no prospectus or similar document is required to communicate the information to purchasers, filed statements and returns are open to public inspection and copies may be obtained from the Commission at nominal cost.

The regulatory approach of the United States securities legislation places emphasis on disclosure, not on direct administrative intervention. Loss notes that "_in principle_, a promoter may ask the public to invest in a hole in the ground as long as he does not without supporting geological data describe it as a uranium strike".[30] The primary purpose of the legislation is to see that investors have access to enough information to properly evaluate the providence of investment and come to their own rational decisions.[31]

Investor confidence is fostered and the cautious are brought to the securities market with the assurance that disclosure will

permit them to discover and avoid the fraudulent. With information, investment risks can be knowledgeably calculated, causing prices to better reflect market potential and thereby contributing to the more efficient allocation of capital resources.

Provincial Securities Regulation

In Canada where securities regulation is a provincial function there is a lack of uniformity in disclosure requirements, and it is not feasible to consider here the various provisions in ten jurisdictions. Because the Ontario system, with some modification, is employed in British Columbia, Alberta, Saskatchewan, and Manitoba, it will be used as the model for discussion.

The Ontario Securities Act[32] makes the same distinction between initial distributions and secondary trading which characterizes the United States legislation.

Subject to several exemptions,[33] companies intending to make a distribution of securities to the public must file with the Ontario Securities Commission a preliminary and final prospectus and must deliver a copy of the final prospectus to purchasers before, or within two days after, the sale. The preliminary prospectus is a summary or preview of the final prospectus. The final prospectus must provide "full, true and plain disclosure of all material facts".[34] It is usually in narrative form and includes such items as: a detailed description of the terms of the offering, a description of the company's business and its general development in the five preceding years, the location of principal properties, pending legal proceedings, the identity and remuneration of directors and officers, material contracts and the time and place where they might be inspected, together with financial statements for the preceding five years consisting of a profit and loss statement, a statement of surplus, a balance sheet and in some cases a statement of source and application of funds.

In relation to both the scope of their application and the kind of information demanded, the secondary market or continuous disclosure provisions of the Ontario statute are much less comprehensive than either its prospectus requirements or the continuous disclosure provisions of the United States legislation. Only those companies which have filed a prospectus with the Ontario Securities Commission after May 1, 1967 or whose shares are listed on the Toronto Stock Exchange are required to comply. They must file annually with the O.S.C. comparative financial statements for the last two financial years consisting of a balance sheet and statements of profit and loss, surplus, and source and application of funds. Where applicable, the notes

to the financial statements must include information concerning: any foreign currency restrictions affecting corporate assets, contractual obligations requiring abnormal expenditures, the aggregate remuneration payable to directors and senior officers and sales or gross revenue figures on a line of business basis.[35] Less detailed interim financial statements must be filed on a semi-annual basis. In addition, companies are required to disclose through the news media, though not necessarily file with the O.S.C., notices of material change and developments as they occur including proposed changes in control, important discoveries or developments in the company's resources or technology, larger than average changes in earnings and generally any other event which could materially affect the value of the security.[36]

The purpose of the continuous disclosure provisions is to provide an up-to-date repository of relevant corporate information which a potential investor or his advisers may use to evaluate issued securites. The shortcomings of the Ontario legislation in this regard have been the subject of much comment[37] and a new Ontario Securities Act has been proposed[38] which borrows additional concepts from the 1934 United States statute. For present purposes, the most significant sections of the proposed Act are those which will require the timely publication and filing of reports of material change, the filing of quarterly returns and the imposition of disclosure obligations on companies not covered by the existing statute.

The Canada Business
Corporations Act

Although the federal government has yet to exercise a direct regulatory presence in the securities market, many of the disclosure obligations found in provincial securities legislation are paralleled in federal company laws. The new Canada Business Corporations Act, for example, requires that a copy of any "prospectus, statement of material facts, registration statement or securities exchange takeover bid circular or similar document" filed with any provincial or foreign securities commission by a federally incorporated company be sent to the Director of Companies in Ottawa where it will be open to inspection by shareholders and the general public.[39] The Act also institutes a regime of disclosure for insider trades, proxy solicitations and takeover bids, matters which are covered by provincial securities legislation as well.

The jurisdictional overlap can be attributed to several factors, not the least of which is the difficulty of distinguishing securities regulation and investor protection from company law and shareholder's rights. Historically, investor protection provisions were an integral element of companies' legislation before the passage of the Securities Acts. The English Companies Act of 1844,[40] for example, required prospectus filings and the disclosure of annual financial statements. Given subsequent

constitutional developments which allocated securities regulation to the provinces, it would not have been unreasonable for the federal government to have retained its historic jurisdiction in order to offer uniform protection to shareholders in the companies which it had incorporated. Moreover, had the federal government relied on the several provinces to formulate disclosure requirements, not only would there have been uneven treatment from one jurisdiction to the next, but gaps would have resulted, placing those companies whose shares were not publicly traded beyond the reach of federal or provincial control.

From a conceptual standpoint, disclosure which satisfies the decision-making needs of shareholders as shareholders under companies' legislation, ought to be more comprehensive than disclosure under securities statutes which satisfied the decision-making needs of shareholders as investors. At the risk of oversimplification, the shareholder as an investor, and particularly as a short term investor or trader, makes essentially one kind of decision, a purchasing decision, whether to buy or sell a company's securities. Although this is less true for the longer term investor, the information disclosed under the securities statutes, particularly with respect to primary distributions and prospectus filings, is intended to assist the investor in making that purchasing decision. Company law, on the other hand, calls upon shareholders to engage in a broader range of decision-making, for in addition to the purchasing decision to sell out or exit from the company, shareholders have access to control procedures which empower them to supervise and direct the course of corporate activity; and to the extent that such decision-making authority survives Berle and Means[41] then there is a need for information upon which control decisions can be based.

The new Canada Business Corporations Act strengthens shareholder control mechanisms and facilitates their operation through the supply of information. In addition to the prospectus provisions mentioned above, all federally incorporated companies, unless exempted, must place comparative annual financial statements before the shareholders at every annual meeting and must send a copy of those statements to shareholders at least twenty-one days before the meeting. The contents of the financial statements are not specified in the statute but are left to the regulations, thus giving them the flexibility to be kept up to date with changing accounting standards without frequent legislative amendment; and unless there is a conflict with the regulations, the evolving concepts of generally accepted accounting principles as set out in the Canadian Institute of Chartered Accountants' Handbook constitutes the standard to be followed in the preparation of the statements.

The regulations state that the financial statements must include a balance sheet, and statements of surplus, income and changes in financial position. Notes to the statements, where

applicable, must offer a brief description of any employee pension or retirement plan, material changes in long term debt, and the details of any loans to shareholders, directors, officers or employees. Moreover, any corporation which offers its shares to the public and any private corporation, the gross revenues of which exceed five million dollars, must show its revenues, expenses and income on a segmented line-of-business basis according to the Statistics Canada Standard Industrial Classification Code where it has revenues from more than one class of business. The Act also provides that a copy of the financial statements of such public and large private companies be filed with the Director of Companies where they will be open to public inspection.

In addition to annual financial reporting, the Canada Business Corporations Act shares with The Securities Act of Ontario and the 1934 United States Securities and Exchange Act the requirement that shareholders be given information upon such nonrecurring events as takeover bids and corporate reorganizations as well as upon matters forming the basis of proxy solicitations.

The disclosure requirements which attach to the proxy solicitation process are coming to be regarded as perhaps the most significant factor for shareholder decision-making.[42] With the large numbers and wide dispersion of share ownership and the impossibility of each shareholder's physical attendance at annual and special meetings, voting on the appointment of directors, the authorization or issue of securities, or other important matters of corporate direction must proceed by proxy through the appointment of agents. The right to act as agent and cast the proxy ballot is usually solicited by management or in some cases by groups of dissident shareholders, but "unlike most agencies in which the principal gives instructions to the agent, the agent holding a corporate proxy has far more information concerning the issues involved than his principal--the shareholder--and as a practical matter determines the matter with respect to which the agency will be created and the manner in which the agency will be carried out".[43]

In response to this situation where an uninformed electorate would make shareholder decision-making and shareholder democracy less effective, the proxy rules impose a standard of full disclosure. It is an offence punishable on summary conviction under the Canada Business Corporations Act for management or dissident groups to solicit proxies in a company of fifteen or more shareholders without sending an accompanying proxy circular in which all material facts relating to a proposal are disclosed. A copy of the proxy circular must also be sent to the Director of Companies and be open to public inspection. If the circular omits to state a material fact or contains an untrue statement of a material fact, the Director or any interested person may apply to a court for an order requiring the correction of the circular or "restraining the solicitation, the holding of the meeting, or any person from implementing or acting upon any

resolution passed at the meeting".[44] The regulations spell out in length the mandatory contents of a proxy circular, and include a general catch-all provision that any matter upon which action is to be taken at a meeting must be described in sufficient detail "to permit shareholders to form a reasoned judgment concerning the matter".[45]

Associated with the proxy procedures is the right of a shareholder to initiate proposals for discussion at the annual meeting. The Act gives a shareholder the right to have a statement in support of his proposal attached to the management proxy circular and distributed to shareholders. The subject of the proposal might be a bylaw or resolution seeking to alter corporate behaviour or calling for greater disclosure. If the proposal succeeds in gaining the requisite majority of shareholder votes, then the corporation must, of course, comply and alter its behaviour or make the necessary disclosure. Using similar provisions in the United States, public interest groups have had a measure of success in attracting the support of large institutional investors in voting for resolutions which would have caused companies such as General Motors, Gulf Oil and International Business Machines to disclose their minority hiring practices or their activities in South Africa.[46]

Shareholders are also given the opportunity to acquire information by making inquiries of management at the annual meeting or by inspecting the company's books and records.

Some Observations on Disclosure for Investors and Shareholders

Two kinds of conclusions can be drawn from the preceding analysis of existing disclosure legislation for investors and shareholders. The first relates to the shortcomings of the present scheme and most notably its narrowness of application and lack of uniformity. The jurisdictional mix of provincial securities acts, provincial companies acts and the federal companies acts, gives rise to an inefficient duplication of government functions, and despite genuine efforts to promote uniformity, imposes multiple disclosure burdens on some firms while obscuring the public visibility of others that inhabit certain jurisdictional gaps. For example, a federally incorporated company whose shares are traded on the Toronto Stock Exchange must comply with the disclosure requirements of the Stock Exchange, the Canada Business Corporations Act, the Ontario Securities Act and very often with the Securities Acts of the other provinces. A large federally incorporated private company must satisfy the public disclosure provisions of the Canada Business Corporations Act, whereas provincially incorporated private companies of similar size and smaller federally incorporated private companies are relatively free from disclosure obligations.

Compounding the confusions for those firms subject to multiple disclosure burdens is the unevenness of requirements governing the content of what to disclose. In general, there is less information required than in the United States SEC filings, but the situation in Canada varies between jurisdictions, from the more comprehensive provisions under federal companies legislation to the minimal requirements of the securities statutes in the Maritime provinces.

The second set of conclusions which can be drawn from the analysis of existing disclosure legislation for investors and shareholders relates to internal corporate control mechanisms and the structure of the capital markets which make such disclosure an effective aid to decision-making.

Turning first to prospectus disclosure and investor protection, it was noted earlier that the information is supplied to assist the investor in making a relatively straightforward kind of purchasing decision--to buy or not to buy a securities offering. The calculations which go into the investor's decision may be complex, but there are only two alternatives from which to choose for any particular offering, and therefore the determination of what information is relevant to investor decision-making can be made with some reliability.

Although the investor can respond to information about a securities issue in only two ways, the number of offerings in the competitive capital market ensure that he will have ample opportunity to act on the information. There are no costs associated with incorrectly deciding not to invest in an issue, apart from the loss of an opportunity and the presence of a resale market minimizes the costs of an incorrect decision to invest. Whatever investment decision is made, the decision-maker is not irretrievably committed to his course of action. These features of wide choice and flexibility commonly occur in competitive markets and give an informed decision-maker the greatest opportunity to evaluate and secure his own interests.

Prospectus disclosure is also effective because it arises in an atmosphere of reciprocal benefit. By filing a prospectus, companies are permitted to raise capital at a rate which an informed and competitive market considers appropriate. In comparison, disclosure which assists environmentalists or competitors will not benefit, and may, in fact, disadvantage a company.

Disclosure to shareholders in the annual financial statements and in proxy circulars lacks the free market features of prospectus disclosure, and relies instead on informed use of internal corporate control mechanisms. Shareholders can

respond to information by selling their shares or by calling upon a number of voting procedures to replace management or alter the course of corporate activity. As with prospectus disclosure, the decision-maker has a wide range of opportunities to act on the information and the capacity to have his decisions take effect, but the determination of what to disclose to shareholders is more difficult, for a great many topics may form the subject matter of a vote and information other than the preceding year's profit statement may influence the shareholders' voting decision.

2. THE QUALITY OF INFORMATION

Disclosure will not operate as an effective deterrent or aid to private decision-making unless the information provided is timely, accurate, relevant and comprehensible. The questions of how timely, or how relevant, are matters for judgment based on the kind of information required, the uses to which it will be put and the practical limitations on its communication.

TIMELY

Yesterday's newspapers are proverbially lacking in value. The timeliness of disclosure is extremely important, for the bases of decision-making will be faulty where present conditions no longer resemble those which existed at the time information was initially relayed.

The time factor is relevant to all types of disclosure but it has attracted the most comment in the securities field. The need for responsive resource allocations in the capital market not only demands that developments be communicated as quickly as possible; but the companion goal of all traders having equal access to information breaks down where a time lag affords insiders and others an opportunity to profit from their special knowledge.

The provincial Securities Acts and the United States Securities and Exchange Commission Act employ two kinds of continuous disclosure requirements in an effort to keep investors up to date. There are the periodic financial statements, furnished under the Ontario Act on an annual basis within 170 days after the period to which they relate and on an interim or semi annual basis within 60 days after the relevant period. In the United States, information is provided on an annual basis within 90 days of the close of the fiscal year and on an interim or quarterly basis within 45 days after each of the first three quarters.

The second kind of continuous disclosure obligation is not periodic but irregular and arises on the occurrence of a material change in the company's position. The policy in Ontario at present is to require companies to publicly disclose such developments as might reasonably be expected to affect materially the value of their securities. Under the proposed Ontario Act, companies would have to issue and file a press release within ten days of the event disclosing the nature and substance of the material change.

The combination of periodic and irregular reporting appears well suited to handle the kind of information which is of interest to investors. For information with a relatively long useful life span which describes events which change infrequently and with little controversy, reporting more frequently than annually is

likely to be unnecessary. Similarly for recurring events or those such as profit and loss positions which require measurement over a regular interval, annual or interim reporting appears apt; and in those situations involving controversial and nonrecurring events which are too important to await the next regular reporting period, material change disclosure does away with the time lag.

Despite being well geared to the kind of information it must handle, the Ontario system may not be sufficiently timely to satisfy the needs of investors. The 170-day delay between the preparation of annual financial statements and their disclosure means that much of their content is too stale to play a significant role in investment calculations. A further point is that annual financial statements are historical and only describe past performance whereas investment decisions are based on performance in the future where the lessons of history can be no more than a possible guide.[47] This objection relates more to the relevancy of information and is therefore discussed at length in a later subsection but it does bear indirectly on the issue of timeliness.

There are certain practical limitations which weigh against more frequent and timely disclosure. Information is often costly both for companies to assemble and for government agencies such as the O.S.C. to file and process. Increasing the frequency of disclosure, for instance, from a semi annual to a quarterly basis would have to promise benefits which offset such costs. As well, there is the problem that more frequent reporting gives rise to duplication and diminishing returns.

Experience with the most timely of disclosures, the notice of material change, demonstrates another kind of practical limitation. Suitable communication channels which can disseminate information on an irregular basis are hard to come by. With periodic or annual statements, the information can either be filed with an agency or directly communicated to interested parties who will know when and where to expect it. The same cannot be said of the press release approach to notices of material change under the proposed Ontario Securities Act.

Disclosure must be timely to be effective. How timely depends on the kind of information, the uses to which it will be put and the costs and limitations involved in its communication. The same considerations apply to all kinds of disclosure; and if the securities market is distinctive, it is no more so than other competitive markets where the need for up-to-date information is acute.

ACCURATE

The bases of decision-making will be distorted where use is made of inaccurate information, and it must be the aim of any disclosure system to reduce or eliminate inaccuracy. The Securities Acts promote accuracy in four principal ways. First, for all continuous disclosure obligations except the notice of material change, the required contents are sufficiently detailed in the forms and policy guidelines to reduce the scope of possible error. Secondly, most Securities Commissions have a screening function enabling them to refuse a prospectus or other document which contains omissions or inaccuracies. Thirdly, verification of financial statements by independent auditors is required; and lastly, both criminal and civil liability await those who make misleading statements and omissions. A similar scheme is employed by federal companies legislation, with the screening function of the Securities Commission exercised by the Director of Companies.

Except for the notice of material change where the lack of intelligible guidelines makes it difficult for companies to determine what and when to disclose, and the element of immediacy eliminates the time for prior screening or independent verification, this four-pronged approach has gone far to reduce the inaccuracies in corporate disclosures. It is reasonable to assume that similar methods would contribute to accuracy for disclosure outside the area of securities law; yet one must bear in mind that this high degree of accuracy comes at a cost which is equally high. Prior screening, form and guideline preparation, and independent verification require institutions and procedures which, in terms of expense, may prove neither feasible nor desirable when weighed against the benefits of greater accuracy for other kinds of disclosure.

Even with the comprehensive measures which apply to securities disclosure, there persists an element of inherent inaccuracy. As language is capable of several meanings and infinite implication, some misinformation is inevitable. Efforts to venture too far from literal meanings in the interests of ensuring the accuracy of implication and innuendo have been thought for other areas of regulation, such as misleading advertising, to be administratively unworkable.

This inherent inaccuracy applies to figures as well as words. Financial statements, for example, are intended to present an accurate portrayal of a firm's finanacial status and performance. The precision of mathematics, however, lends to them a deceptive air of certitude, for such statements are not necessarily consistent over time nor between firms; and the common denominator of "generally accepted accounting principles" can lead to several generally accepted but different results.[48] The accountant's skills are as much skills of judgment as they are of measurement. He must

choose those accounting methods which appropriately depict the unique qualities of each enterprise and as a result, there is a sacrifice of inter-firm or inter-industry uniformity. As R.M. Skinner notes:

> ...these problems are inescapable. If we are to have truthful reporting we can not avoid estimates, valuation and the exercise of professional judgment. If we leave open the use of judgment we accept the likelihood of occasional inconsistent judgment. On the other hand, if we do not permit some judgment, such is the complexity of business activity that we will not be able to reflect it accurately.[49]

Investment decisions, however, depend on interfirm comparisons, and both the accounting profession and government administrators have been seeking both greater standardization and fuller explanations in the notes to the financial statements. At the federal level the regulations under the Canada Business Corporations Act go so far as to specify that financial statements must be prepared in accordance with the recommendations in the Canadian Institute of Chartered Accountants' Handbook. These efforts will likely bring about some improvements in standardization and consistency; but without a substantial sacrifice of flexibility, a degree of misinformation is unavoidable.

The inaccuracies that are caused by the subjective or judgmental element in descriptive communication apply as well to other kinds of disclosure. The problem in fact is more serious for nonfinancial information because the conventions of an established accounting profession are not available. It is one thing to suggest that corporations should provide information about the competitive conditions of their product markets or their minority hiring practices but quite another to devise a suitable means of accurately quantifying and communicating that information.

<u>RELEVANT</u>

Information must be relevant to the needs of its users. Most information, however, admits of a multiplicity of both intended and unforeseeable users making the decisions of what information to disclose extremely complex.[50] If interests in addition to those of shareholders and investors are recognized as being legitimately entitled to corporate information, systems would have to be devised to measure and communicate data relevant to those interests. It would not be sufficient to merely permit public access to financial statements and proxy circulars under the Canada Business Corporations Act, for that information has been tailored to the relevant needs of

shareholders and investors. In the same way that the focus of accounting in the last half century has moved from creditors and the balance sheet to investors and the income statement, so too would it be called upon to adapt, should the scope of disclosure be expanded to countenance a broader range of interests.

There are also pressures to define relevancy not in terms of recorded events but in terms of forecasts and predictions. Decisions are made for the future and in a world of accelerating change, past performance may no longer be the best guide. As Homer Kripke, one of the leading proponents of this view maintains:

> As we move into the future of constant technological change and vast national and international shortages and strains, we have no choice but to experiment with disclosure with a forward look instead of marching backward into the future.[51]

Kripke's comments are directed to the SEC and relate to the kinds of information which he considers relevant for investors, but they apply with equal force to all disclosure.

There are, of course, limitations on predictive or forecast disclosure, mostly stemming from the obvious fact that the future is unknowable. The same degree of accuracy which attaches to the telling of past events cannot be expected, and one must rely on the good faith opinions and expectations of corporate management. Consistency is less likely because management differs in experience, outlook and predictive skills.

It would also be necessary to reach some consensus on how far into the future disclosure should extend. Generally, short-range forecasting is the least useful but the most reliable whereas the opposite is true of longer range forecasting. Moreover, while it may be reasonable to ask companies to forecast events over which they have some control such as their own development plans, there are many external events such as legislative changes or actions by competitors or suppliers which materially affect corporate performance but which are beyond the predictive skills of management.

These are but a sampling of the considerations raised by predictive disclosure. Their apparent complexity does not detract from Kripke's assertion that prediction may be more relevant to information users than the lessons of the past. What it does suggest, however, is that forecast disclosure involves an entirely different set of issues, which require extensive analysis and experimentation in order to formulate a fair and reasonable system of measurement and communication.

COMPREHENSIBLE

The utility of disclosure is eroded where the information is not communicated in a form which is easily understood by those who are to use it. As corporate information interests a broad range of users possessing varying interpretive skills, it has become extremely difficult to describe increasingly complex corporate events in a manner which is comprehensible to the unsophisticated but which is not so general as to be misleading or meaningless for the experts.

In the case of securities disclosure where the audience encompasse both the professional investment analyst and the widow with 100 shares of Imperial Oil Limited, two positions have been articulated. The first approach, and one which is being used by the SEC, is a process of "differential disclosure" which is a best-of-both-worlds approach providing the analyst with detailed financial data and the widow with more simplified information.[52] Advocates of the second position suggest that financial disclosure need only be directed to the expert or professional, because the layman will not be able to comprehend or use the technical information in the prospectus, nor will the simplified version be of as much utility. Since the unsophisticated widow must deal through a broker, she has access to the interpretive services of experts in the brokerage house who can explain the information and counsel her.

The problem may be more serious for disclosure outside the securities market where relatively costless interpretive services may not be available. Moreover, wherever interpretive costs are involved, they disrupt the economic advantages of inexhaustible consumption which essentially maintains that information, unlike other commodities, can be consumed costlessly by any number without using it up.

Related to the issue of comprehensible information are questions concerning the physical limits of human beings to absorb and use data. There is a point where the senses become overloaded and the ability to filter and evaluate incoming information is impaired. There can, in effect, be too much disclosure.[53] In the securities context, some have contended that comprehensive or full disclosure actually defeats fair disclosure, as investors turn from the heavy flow of detail to simplistic measures such as price/earnings ratios.[54]

One means of minimizing overload is through technological improvements in information storage, handling and distribution systems. At present, information is either disclosed directly through the mails or stored in a central repository to which the users are given access. In either approach, too much emphasis may be placed on the written word and too little use made of computer technologies and indexing systems which can selectively reproduce information upon demand. In this regard, Quebec's Central Business Register, though not specifically a disclosure device, may be a worthwhile model for other jurisdictions to consider.

3. THE CORPORATE JUSTIFICATION FOR LIMITING DISCLOSURE

Canadian corporations generally have not been favourably disposed to disclosure, or as one commentator colourfully noted, they have exhibited "a maidenly reluctance" to expose their innermost corporate details.[55] Although the response may be attributable in part to a psychology of conservatism, there are four principle reasons why corporations might be legitimately opposed to disclosure: the possibility of competitive harm, the burden of costs, the possibility of distortion, and the invasion of privacy.

COMPETITIVE HARM

Companies often assert that some kinds of information might be used by competitors to the detriment of the reporting firm. Thus one finds that under The Ontario Business Corporations Act, public companies which are required to disclose sales or gross operating revenue figures as part of their statements of profit and loss can apply to the O.S.C. for an exemption "where the disclosure of such information would be unduly detrimental to the interests of the corporation".[56] The experience with this provision indicates that the notion of detriment has often been misconceived, and exemptions granted for what is no more than the normal give and take of a healthy competitive market. There is indeed a legitimate corporate interest, as well as a public interest, in not compelling the disclosure of information which can cause very real competitive detriment to the reporting enterprise. The difficulty of course is to determine the nature of that detriment.

Before one can appreciate the concept of competitive harm it is necessary to come to an understanding of certain unique economic properties of corporate information.[57] Like most other commodities, information can be costly to produce or assemble, but unlike other commodities the cost of its production bears no relationship to the extent of its output.[58] The accountant's charges for preparing annual financial statements, or in other words, the cost of assembling information, is approximately the same whether the statements are circulated to 100 or 100,000 shareholders, whereas the cost of raw materials such as paper, ink, printing and postage depends upon output. Thus, there are economies of scale in the production of information.

More importantly, information differs from most other commodities in that once produced, its consumption is "non-rival" or inexhaustible.[59] There are no natural limits to the number who can use or enjoy it. Being intangible, the information in financial statements, unlike the tangible assets which they

describe, can be consumed by all interested parties without depleting the original supply. In the words of one economist,[60] "information is a superb example of a public good" and any effort to restrict its consumption will defeat the advantages of costless multiple usage. As long as the information can be used by someone, it would be inefficient to obstruct that use since the costs of consumption at the margin are nil, although there may be certain transaction costs associated with distribution.[61]

On the other hand, because the production of information is costly, and because economic value is a measure of scarcity, there will be no incentive to produce some types of socially useful information unless appropriation by others can be prevented. The problem is illustrated by the Editors of the Harvard Law Review:

> A symphony written by one man may then be conducted and recorded by any number of others. No natural limit exists on the number of unaffiliated radio stations which may intercept and rebroadcast a radio performance of the work. Yet, though the appropriated intangible is not lost to the originator, its market value--largely dependent upon the intangible's scarcity--is lost or at least diminished. Thus if the author cannot limit the performance of his symphony once a score appears publicly he cannot charge the orchestra, recording company or radio station for the subsequent use of his intangible creation....Since the supply of the product, once created and made available, is naturally unlimited, the supply must be legally limited or the demand for the product, no matter how great, may never produce a profit from the intangible.[62]

Copyrights and patents are the most notable examples of legal or artificial limitations to protect the supply of information. They offer the innovator the incentive of an informational monopoly which would allow him the exclusive right to reap the fruits of his own creative efforts. In return, there is a net social gain from the dissemination of knowledge and information which might not otherwise be discovered or disclosed.[63]

The patent system only covers a very small portion of the information produced by corporations. Somewhat similar ends are achieved by protecting trade secrets or breaches of fiduciary obligations, where instead of granting an exclusive patent or property right good against all the world, measures are taken to restrict others from using unlawful methods to acquire information. The majority of corporate information, however, is protected from appropriation, not by law, but by

corporate secrecy. Each enterprise is left to its own devices to safeguard the information it has assembled or produced. To the extent that it is successful, the concealed information retains its value, in terms of a measure of scarcity, and the company is free to exclusively exploit the information in the best way it sees fit. If the enterprise is then called upon to disclose, the data being inexhaustible will not be lost, but the surrender of exclusivity will take on the appearance of a property loss as the company is deprived of the scarcity value of the information.[64]

To return to the above example of the symphony, where dissemination is not controlled, the composer loses the right to be compensated for his work and ultimately the public loses the opportunity to listen to symphonies. Similarly, it is against the public interest to require disclosure that could competitively disadvantage the company producing the information and thus discourage the future creation of economically valuable knowledge.[65] Information of this type would relate to production processes, formulae, customers lists, the results of geological exploration, market surveys, planned operational changes and more. The list does not here admit of exhaustive definition; but generically all items share the common feature that if their disclosure were required, a corporation would likely cease producing the information or cease carrying on the activity to which the disclosure related and leave both itself and the public worse off than if disclosure were not required.

The potential for competitive harm is complicated by the unforeseeable uses to which information might be put and the interrelationships of those who would be interested by the data. For example, while it might be socially desirable to inform workers before implementing an innovative plant process which might cost several men their jobs, competitors could appropriate the information to their own advantage. The impracticality of containing these overflow effects thus calls for a cautious, lowest common denominator approach to weighing the possiblility of competitive harm.

The majority of corporate information, including everything which must be disclosed under existing Canadian legislation, fails to give rise to the kind of competitive harm here considered to be deserving of exemption. Rather than suffering any particular detriment, the public interest is often served when competitors knowledgeably exploit the information contained in financial statements. The disclosure of large profits, for example, can alert competitors to the advantages of entering a particular market and can lead to the efficient allocation of productive resources. The disclosing firm suffers harm in the sense that the presence of competition will likely reduce the level of its profits but that kind of harm is no more than the play of market forces responding to the proper signals

and operating as they should. To define competitive harm from disclosure as simply a loss of profit would be inconsistent with a private enterprise economy as it would insulate competitors from normal market forces and allocate resources not to the most efficient producer but to the most efficient concealer.

There is, however, a second type of competitive harm to which the loss of profit test has been applied, and where the disclosure of competitively significant information is thought not to be desirable. It essentially involves an exemption where, because of foreign competition or market conditions, a firm is uniquely subject to a disclosure obligation and exposed to the forces of competition without the offsetting benefit of having access to information about its competitors. Unlike the earlier definition of competitive harm which focused entirely on the nature of the information to be disclosed and applied equally to all firms, the second involves the assessment of market structures and must be applied on a firm by firm basis. Rather than suggesting the exemption of a class of information, it suggests the exemption of a particular firm.

Whereas one can avoid competitive harm of the type first described by simply not requiring its disclosure, the same approach cannot be used in the second instance. Because it is not feasible to style a disclosure provision with sufficient particularity and foresight to protect the uniquely burdened competitor, an administrative process must be created to assess market structures and adjudicate on exemption applications as they arise. Under the exemption from public disclosure provisions of the Canada Business Corporations Act, this function is delegated to the Director of Companies;[66] under the Canada Corporations Act to a Supreme Court judge;[67] and under The Securities Act of Ontario to the Ontario Securities Commission.[68]

The language of the exemptions varies under the three statutes but in general an applicant must first demonstrate that its competitors do not disclose similar data, either because they are foreign companies, or privately incorporated, or conglomerates which consolidate all line of business results in one statement; and secondly they must show how the disclosure will be detrimental.

An examination of some of the cases is instructive. The Ontario Court of Appeal, in _Re Niagara Wire Weaving Co. Ltd._,[69] granted an exemption where the applicant was the only company subject to disclosure and where detriment "would come from the more aggressive promotion of products from Europe and Japan which might result from a disclosure making available figures with respect to the size of the North American Market".[70] In _Re Firth Brown Steels Ltd._[71] the same court granted an exemption where the applicant was the sole disclosing firm and where competitors could gain so deep an insight into its business

position that they would seek to direct their competitive efforts at its most vulnerable points. In *Re* St. Lawrence Starch Co. Ltd.,[72] the Ontario Supreme Court found undue detriment in the increased likelihood of price reductions by competitors.

In a private enterprise economy, price cutting, new entry and the exploitation of vulnerabilities by competitors are all signs that the applicant for exemption is reaping more than normal profits. Out of an apparent solicitude for the uniquely situated enterprise, a test of harm has been enacted which conceals market opportunities and insulates firms from the forces of competition. In contrast, the parallel provisions of the United States Securities and Exchange Commission Act have been accorded so moribund a repose that they have been used but once in the last forty years[73] and there is no similar provision in England.

In a recent article,[74] David Johnston contends that because the Canadian continuous disclosure experience is too new and the Canadian economy sufficiently distinctive, the sales figure exemption should not at this time be abandoned. There are, however, compelling reasons to the contrary. The costs of the exemption are high, directly in the administrative structures required for adjudications, and indirectly in the misallocation of productive resources, obstructions to entry and the general interference with competitive forces. The exemption is difficult to administer. Johnston, in examining the experience with the exemption to date notes that "there is still a considerable amount of vagueness both about the evidence to be adduced in the exempting application and about the benchmarks against which the test of detriment is to be measured".[75] He attributes this to the paucity of legislative guidelines, but in fact the kind of detriment with which the exemption is concerned takes place in economic conditions so complex and so varied that further guides to discretion may be impractical.

The exemption is disconsonant with the trend of expanding disclosure. The possibility of uniquely burdened firms will diminish as disclosure obligations are extended to larger private companies and as conglomerates are compelled to provide information on a line of business basis. As for protecting domestic competitors from foreign entrants, a sales figure exemption is an extremely dull instrument concealing opportunities for potential domestic entrants as well, and obscuring the operation of more visible and precise protective measures associated with trade and tariff policy.

COST

Disclosure operates very much like a tax, increasing the firm's cost of operation but producing no marketable product. In the long run, like taxes these costs are passed on to the

firm's customers, shareholders, employees and the taxpaying public, but as noted in the preceding subsection, the economic properties of information render it unlikely that the costs can be passed on to the intended users or consumers of the information.

For disclosure which takes place in an atmosphere of reciprocal benefit--where, for instance, the company circulates a prospectus in order to solicit capital--corporate objections to the cost burden are less likely to be heard than in situations of expanded public disclosure where the costs fall exclusively on the firm and the benefits solely on the users. In such circumstances, there is no cost disincentive to limit the content or number of information demands by users, but there is a legitimate corporate interest in opposing such demands for their cost and a legitimate public interest, at least in a general sense, to see that the benefits of disclosure bear some relationship to its costs. This is not to suggest a cost-benefit analysis for each piece of information. That would be impractical, because one cannot adequately quantify benefit variables given that the effects are prospective, that many users may be unforeseeable and that such things as deterrence and improved decision-making simply defy measurement. It does suggest, however, that efforts to expand disclosure should proceed with caution, experimentation and feedback from corporations and from the public.

One should also keep in mind the fact that some information is more costly to produce and assemble than others. Generally, the most costly type of information demand is one which is unprecedented or which calls for new methods of processing. Where companies periodically collect and assemble data for internal use, for government, or for the public, information systems or networks are established which can be used repeatedly without generating many additional costs. Other considerations aside, it would not, for example, add to the firm's costs if its tax returns or now confidential CALURA B returns were made available to the public. In contrast, an obligation to file an environmental impact statement or to assemble financial data on a line-of-business basis where that method was not employed internally would generate high costs as the company would have to develop new methods of quantifying and presenting the information.

As corporate structures become more complicated from growth and concentration, and as ever more interests are affected by corporate activities, the logistics of providing relevant descriptions will likely entail ever increasing costs and cause companies to justifiably advance this factor as the primary basis of opposition to more disclosure.

The costs of disclosure pose more hardship for some companies than for others. As noted earlier, there are scale economies in the production of information. In terms of the approximate cost of producing the same information, a smaller firm must expend a greater portion of its resources than a larger one. On the other hand, the public significance of the smaller firm and the benefits which might flow from many of its disclosures are likely to be minimal. Under such circumstances, there appears ample reason to impose a minimum size limit for corporations subject to public disclosure obligations in much the same way the federal government has done under CALURA and the Canada Business Corporations Act.

In most instances, the firms falling below a size limit based on sales or assets will be private or closely held corporations, but it should be noted that it is the fact of their size and not the method of their incorporation which justifies exemption.

DISTORTION

A further corporate objection to disclosure is that some kinds of information are inherently controversial and induce an exaggerated short-run response which might damage the company's reputation or its ability to carry on business. The objection is not based so much on what should be disclosed but on how it should be disclosed. For example, the requirement under the proposed Ontario Securities Act that notices of material change be circulated by press release is open to the objection that press publication highlights the information and obscures other data relevant to a more balanced view.

Although one cannot deny that the method of distributing information can give rise to some distortion, the problem may be unavoidable. If a disclosure scheme is to be responsive to the public, it must invariably generate information which the public regards as controversial. The recent disclosures in the United States that several corporations had paid improper commissions to foreign officials attracted a great deal of press coverage and public attention causing several countries to review their contracts with those firms. In all likelihood some of these corporations will suffer a loss of business and irreparable damage to their reputations which in retrospect many might regard as excessive; but there is not any way to avoid this result. The public demand for the information warranted its disclosure and the intensity of the demand would have caused the "highlighted" response and press coverage no matter what method of presenting the information might have been used.

INVASION OF PRIVACY

A less tangible, but no less significant argument for limiting disclosure rests upon the corporate claim to a right of privacy. Although there has been a good deal of philosophical

discussion concerning the composition of that right, it essentially means an inherent right to be left alone. In the case of individuals, psychological and anthropological evidence is often led to demonstrate every person's need to preserve their own autonomy. In the broader context, privacy is thought to be essential to the independent private decision-making that is fundamental to democracy and a market economy.

The corporate claim to privacy has never been given much credence, particularly because traditional conceptions of corporate personality tended to regard the company as a fiction fabricated by the sovereign. In the era of the letters patent company, incorporation arose at the will of the monarch who then had the unqualified right to supervise and be informed about every aspect of his creations. Our notions of corporate personality, however, are changing and the process of incorporation can no longer lend itself to so formalistic a disposition of the corporate claim to privacy. In many jurisdictions, the letters patent formula has been replaced by the simple filing of articles of association through which incorporation is given effect, not by sovereign will, but by right. The Canada Business Corporations Act, now makes explicit the proposition that federal companies have all the rights of a natural person.[76]

Having the "rights of a natural person" may lift the corporate claim to privacy over a theoretical threshold, but it still does not establish the right for there are many obvious factual differences between corporate and individual persons. It makes no sense, for example, to speak of a corporate right to be free from sex based discrimination simply because such entities lack gender. The question then becomes whether the right to privacy is analogous to that right, and therefore unique to individuals, or whether it is like the right to contract and therefore capable of meaningful application to corporations.

The answer lies in a fuller analysis of what is meant by privacy. Resort to legal definitions is of little help; unlike many American states, a common law right to privacy never developed in Canada for individuals or corporations.[77]

Several major studies on privacy have been undertaken in the last ten years but few have dealt with the issue of corporate privacy.[78] In *Privacy and Freedom*,[79] however, Alan F. Westin contends that, not just corporations, but all organizations including governments, religious associations and political parties have a need for privacy. He notes that "organizational privacy is needed if groups are to play the role of independent and responsible agents that is assigned to them in democratic societies".[80] Not only does Westin see privacy as preserving organizational autonomy, but he also finds it essential for the protection of internal communication and evaluative periods of decision-making.

The Westin analysis is compelling. In its application to corporations, the approach is highly functional and thus consistent with evolving concepts of corporate personality. It leads one to the conclusion that the _de facto_ differences between corporate and natural persons colour but do not preclude the meaningful application of the right of privacy to corporations.

Westin's work is also valuable in another respect, however, for the breadth of its analysis demonstrates that there are a multitude of diverse situations in which individuals and corporations possess the need for privacy. To unify these situations is to resort to considerable abstraction, and that is the level at which the substance of the corresponding right to privacy is best understood--not as a rule, but as a principle.

At the level of principle, however, the right of privacy must compete with other principles, one of which is the public's right to be informed about activities which materially affect its welfare. The weight of this latter principle increases with social complexity, and as Paul Freund notes:[81]

> ...as the area of relevance, political or scientific, expands, there is strong psychological pressure to yield some ground of privacy.

The point has its greatest significance for the corporate setting, where the growth of corporate power has pervaded the social and economic fabric of Canadian life, accentuating the importance of the public's right to be informed and justifying encroachments on the principle of corporate privacy.

Where the balance is drawn is a matter of judgment. There is in fact very little guidance in the literature. The Watkins[82] and Gray Reports,[83] when dealing with the issue of corporate disclosure to government, took the position that there was no kind of information which should be held back. There are, however, two significant differences between those studies and this one. The Watkins Report expressed, and the Gray report implied, a reliance on the old formalistic concept of corporate personality where the sovereign had the right to be informed about every aspect of his corporate creations.[84] Secondly, the issue of present inquiry is disclosure to the public, not disclosure to a government able to employ doctrines of confidentiality and thus limit further circulation of the data. The approach of the Watkins and Gray Reports therefore provides no assistance. Much like the preceding discussion on the costs and benefits of disclosure, one cannot satisfactorily balance the interests in the abstract. The importance of the public's right to know and the corporation's right to privacy can only be calculated when a specific instance of corporate disclosure is under consideration.

Some general observations, however, can be made. Firstly, larger concentrations of corporate power are likely to have larger effects on the public welfare, more readily displacing the privacy interest and thereby justifying the practical application of bright line tests of corporate size based on revenue or asset figures.

Secondly, there is likely to be a more substantial privacy interest where the information being sought relates to specific communications, dealings, or negotiations currently being carried on between the company and third parties, because disclosure can impair the corporation's ability to assume bargaining postures. A common example occurs when companies are called upon to inform shareholders and investors of the amount which the company believes it must pay in a pending civil damage suit. If the plaintiff learns of the figure, the company can no longer attempt to strike a settlement below that amount.

By way of final observation it should be noted that the distinction between public and private companies relates only to the distribution of share ownership. It is not relevant to the issue of corporate privacy. General Motors of Canada, a private company and wholly owned subsidiary of one of the world's largest corporations, in light of its public impact should have no greater claim to privacy than a company of similar size, the shares of which are publicly traded. If privately incorporated companies are to be excluded from disclosure on the grounds of a right to privacy the justification must be based on their small size or minimal public impact but not on the distribution of their shares.

4. EXPANDING CORPORATE DISCLOSURE

In the last decade, there has been a proliferation of interests demanding more access to more corporate information; yet as the preceding chapters indicate, disclosure is an exceedingly complex legislative device. Far from being universal, its effectiveness depends on a great many factors including the purpose of its application, the content and quality of the information, and the context in which it is used. It is against the backdrop of these conditions that the following claims for greater disclosure must be considered.

IMPROVED PRIVATE DECISION-MAKING

As the securities experience demonstrated, disclosure can present and clarify alternatives for private decision-makers. In most instances, the kind of decision-making with which we are concerned is economic, and the alternatives are those presented by various market relationships. This is not to imply that disclosure will not assist decision-making in non market relationships but it does suggest that informed decision-making can only make sense where a forum exists in which individuals have the capacity to make choices; and outside of shareholders' meetings and the political process that condition is most commonly satisfied in a market setting. For clarification, we are not considering here the deterrent qualities of disclosure but only its effects on decision-making.

COMPETITORS

In the neo classical economist's model of perfect competition, perfect knowledge and the absence of uncertainty are treated as given assumptions. In effect, the decisions of competitors, as well as those of consumers and suppliers are assumed to be wholly informed and rational.[85] Observation, however, proves those assumptions false, and imperfect knowledge joins with other departures from the model of pure competition in the real world of today's mixed economy.

Is it then reasonable to assume that if one were to use corporate disclosure to overcome imperfect knowledge, it would result in improved decision-making and a move towards a more competitive environment?[86] As the highly competitive capital market demonstrates, information stimulates competition by enabling firms to knowledgeably calculate the best method and direction for their competitive efforts; that in turn, leads to production by the most efficient and ultimately to the optimal allocation of resources. For those sectors of the economy, like the capital market, where competition is vigorous, where firms relative to each other are small and none exercise monopoly power, these effects may very

well materialize. Once informed, the most efficient should enter the market and the least efficient should be discouraged beforehand from wastefully committing resources. Yet few sectors of the modern Canadian economy can be characterized as being inhabited by numerous small and vigorously competitive firms. Many industries are highly concentrated. Often there will be three or four large firms whose preferences run to stability rather than competition. To provide such firms with additional information about each other might further erode whatever competitive incentive that remained. The key fact is that information does not promote competition per se. It promotes rational decision-making, and rational decisions in a concentrated industry tend to produce co-operation, not competition.

For example, under present combines legislation it is unlawful for firms to enter into agreements to maintain prices or restrain trade but it is not illegal for them to independently follow parallel practices which lead to a similar non competitive result. Without up-to-date information, it is extremely difficult for firms to consciously parallel each other's practices; and, although some of the requisite information on costs, output and pricing may already be circulated through trade associations and other means, more detailed disclosure could easily facilitate co-operative efforts.

In certain industries, more detailed disclosure may not only encourage co-operation but it may also discourage the more aggresive competitors from abandoning parallel activities. The prime incentive to break from a stable arrangement is the incentive of high short-run profits. For example, in some markets a firm might lower its prices to a major purchaser in order to capture a larger share of the market and increase its total revenues before its competitors caught on and countered with matching offers. If frequent detailed disclosures were required from which competitors might learn of changes in output or lower contract prices, the incentive of high short-run profits would disappear and it would be preferable for a potential price-breaker to co-operate rather than receive reduced revenues from lower prices for the same share of the market.

The use of information to discourage competitive practices is more likely in oligopolized industries but it can also occur where an overabundance of small firms are confronting a declining market and where many will be forced out of business by competition. This was the situation facing United States hardwood manufacturers in the early 1900's, where several hundred firms formed a trade association to promote uniform practices and product standardization through the exchange of information. The United States Supreme Court struck the scheme down under the antitrust laws, for as Mr. Justice Clarke stated: "genuine competitors do not make daily, weekly and monthly reports of their business to their rivals."[87]

If market-related disclosures cannot be relied upon to promote competition between existing firms in a particular industry, what effects might it have on potential entrants? The model of perfect competition regards high profits as a signal for entry, and in an industry with low start-up costs the disclosure of detailed profit data, for example, should constitute an inducement for others to enter. In more practical terms, however, no firm would enter a market on the basis of profit data alone although the information could serve as a cue for potential entrants to make more comprehensive market studies. Even then there could be problems. In some industries there may be concealed barriers to entry such as hidden start-up costs or interlocking patent monopolies and, unless this information was also disclosed or readily detectable by market studies, there could conceivably be a problem with over-entry and the resultant dislocation of business failures. Moreover, not all new entry takes place by the establishment of new businesses. Often the only firms with the resources to surmount entry barriers are the larger enterprises and they would most likely proceed by acquisition, taking over an existing firm through vertical, or conglomerate expansion, rather than starting wholly new operations of their own. The result would be greater corporate concentration, and instead of increasing the number of competitors, disclosure-induced entry might leave the number the same but increase corporate size and power from such vertical or conglomerate acquisitions.

Given this description of market conditions and the likely effects of disclosure on competition, what information might be most beneficially disclosed? Clearly not innovative or trade-secret data, for as noted in a preceding subsection, that would competitively injure the reporting enterprise and ultimately discourage the production of socially useful knowledge. Of that which remains, the most competitively significant information would be production-related financial data on a line of business basis detailing per plant or per product costs and revenues and nonfinancial market data identifying competitors and principal customers, setting out the principal bases of competition such as price, service, warranty or performance upon which the company competes and explaining, where applicable, why certain firms dominate the industry. It should be noted that the above information is disclosed annually in the United States pursuant to the Securities and Exchange Commission Act, Form 10-K.

As for the more detailed financial data, the relevant cost and revenue figures for the single-product firm are presently revealed in its financial statements. The same cannot be said, however, of multi-product diversified companies and conglomerates which publish their financial statements on a consolidated basis. By aggregating the costs and revenues from each line of business, a total figure is arrived at which obscures the profitability of the component products and divisions.

In response to the problem of information loss from consolidated financial reporting, the regulations[88] under the Canada Business Corporations Act require that public and large private companies break down or summarize their financial statements for each class of business which contributes ten or more per cent to the firm's revenues. Unless the directors decide upon an alternate classification technique, the determination of what constitutes a class or line of business follows the Statistics Canada Standard Industrial Classification Code. Under the Ontario Business Corporations Act public companies which, in the opinion of the directors, carry on two or more classes of business are obliged to divide their sale or gross revenue figures among those classes which comprise 15 per cent or more of the total gross revenues of smaller companies or 10 per cent or more of the total gross revenue of larger companies.[89]

The federal provisions have not been in operation long enough to gain any measure of their effectiveness, but similar line of business reporting requirements in the United States have been the source of considerable controversy. Since 1969, the S.E.C. has required companies to present separately the sales and income figures for each line of business that accounted for ten or more per cent of total sales or income. The definition of what constitutes a line of business is determined by the corporation in much the same way that it is under the Ontario Business Corporations Act; but critics have contended that allowing firms to define categories nullifies the benefit of line of business reporting because there is no external standard such as the S.I.C. code to promote uniformity and allow more accurate interfirm comparisons.[90]

There are problems, however, with externally imposed definitions of a line of business and nowhere have such problems been more vocally raised than in the opposition to the second type of line of business reporting in the United States--the Federal Trade Commission's Form LB requirements.[91] In April 1975, the Bureau of Economics Staff of the F.T.C. issued a Supporting Statement on the Proposed Revision of Form LB which defined the purpose of the Line of Business Program as follows:

> The purpose of the Line of Business program is to collect and publish in aggregated form statistical information on economic performance in more than 200 industry categories for a sizeable sample of large corporations active in the U.S. manufacturing sector. Such information, it is believed, will have many important uses. It will help the F.T.C. carry out its statutory mandate to investigate the extent of competition in the U.S. economy and to report the findings of such investigations to Congress and the public. Access to the aggregated statistics on profitability, sales promotion costs, expenditures on research and development, and the

> like will enhance the Commission's insight into how well competition is functioning in the nation's major industries, and hence permit it to allocate its enforcement resources in the most effective manner.[92]

The statement goes on to list benefits for economic researchers, for potential entrants and for company executives to judge their own performance against industry-wide averages. The first F.T.C. line of business questionnaire was sent to 345 corporations in August of 1974 and although many firms responded, more than 200 companies took legal action in opposition to the request for information, and the matter has yet to be finally resolved by the courts.

Form LB is not a public disclosure requirement. The information is to be treated in much the same way as corporate income tax returns or the CALURA B returns which are aggregated and rendered into statistical form before being released to the public. Its significance for a study on disclosure relates only to the problems of accuracy and reliability occasioned by presenting financial data for widely divergent corporate activities on a uniform standardized basis. Where the lines or categories of business are narrowly drawn, firms not only encounter difficulty attempting to "fit" their activities into the right "slot" but the element of judgment inherent in "slot" selection contributes to inaccuracy. On the other hand, where the categories are broadly drawn, the information can become too general to be useful. There are other shortcomings of the line of business approach which stem from its component focus. It is, for example, ill designed to handle the allocation of costs such as the president's salary, which are common to all categories, or to establish a fair method of pricing for internal transactions and transfers between categories.

The second type of information which has significance for competitors and competition relates to nonfinancial market data. The annual Form 10-K report filed with the S.E.C. in the United States calls for a narrative explanation and identification of, among other things, principal products and services, competitors, principal suppliers, the bases of competition and inventory levels together with information on management and key personnel.[93] In 1974, the S.E.C. considered, but then abandoned, a proposal to also require the disclosure of market studies.

The intended users of this kind of information in the United States are investors. There is no indication what effects the disclosure has on competition or of any uses to which the information has been put by competitors or potential entrants. At best one could speculate that the information might be relevant as a starting point or a first signal for firms contemplating entry into a particular market.

SUPPLY RELATIONSHIPS

Capital

Capital markets are distinctive for the quantity of information already available to suppliers. Larger lenders such as banks are able to demand whatever information they need directly from corporate borrowers as a condition of supplying credit. Developments in securities regulation, a term almost synonymous with disclosure, have improved the bases of decision-making for investors in debt and equity securities.

There are other capital supply relationships, with trade creditors for example, which might benefit from such changes as more timely financial reporting. There are also areas for expanding securities disclosure such as Professor Kripke's recommendations for forecast data but further consideration of these issues would divert the present study too far into a discussion of securities regulation. They will not be considered here except where there are broader implications for other sectors of the economy. Suffice it to say that disclosure has been an effective and important aid to decision-making by capital suppliers, and there is reason to assume that many of the proposed refinements could improve that process.

Labour

The labour market possesses many of the characteristics which makes disclosure so useful in the shareholder and securities market settings. Not only is there a unified, commonly interested and easily identifiable audience for the reception of information, but the collective bargaining process is in many respects comparable to the shareholders' meeting as an appropriate forum for informed decision-making.

Labour claims to require detailed information on a firm's cost and profit figures in order to knowledgeably bargain for wages. At present, where revenues are not broken down on a per plant, per product or per region basis, unions have contended that it is difficult to measure the worker's contribution to profits and therefore difficult to fashion appropriate wage demands. This problem is more acute with nondisclosing private companies or branch operations of foreign firms where no finanacial data is available.

In a free market setting, negotiations by informed parties should lead to the optimal allocation of productive resources and a wage that properly reflects the workers' input. Yet no one would realistically consider the labour market competitive, as the concentrations of labour in international unions equals and often surpasses corporate concentrations. Unlike capital, labour lacks mobility, and neither the worker nor the firm has

much of an option to shop elsewhere. In these circumstances, one is given cause to question the benefits to the labour market of more detailed financial reporting. Often such information would not be used, particularly where wage levels were negotiated on an industry-wide basis without reference to individual plant or firm revenue figures. Moreover, the corporate claim to privacy here assumes relevance, as disclosure may interfere with the dynamics of negotiation by depriving management of an important bargaining posture--namely, to deny the profitability of a particular plant or operation.

Labour's interest in corporate information and corporate behaviour, however, like the shareholder's, is multidimensional and extends beyond remunerative issues. Working conditions and plant safety, although comprehensively regulated by government, also form the basis of union-management negotiation. Although much of the relevant health and safety information is obtained first hand simply by in-plant observation, thereby making the need for its disclosure redundant, there remains a body of nonobservable data some of which already may be confidentially supplied to or by government that ought to be publicly disclosed.

In a civilized industrial society, it is inconceivable that working conditions which might jeopardize a worker's health or safety are not immediately disclosed. Although such information would be highly controversial and the response to it potentially distorted, and although the lack of medical consensus on the causes of industrial diseases places many such disclosures on a speculative footing, every worker should at least have an opportunity to weigh such information before choosing to work in such surroundings. Perhaps the matter lies outside the domain of corporate disclosure legislation and is properly the subject for a labour conditions statute but there is much to be said for a positive obligation for immediate disclosure much like the notice of material change in the capital market.

MATERIALS

The disclosure of detailed cost and profit figures should assist a firm's material suppliers in making price and output calculations and in deciding upon trade credit terms. Although this should ultimately lead to more efficient resource allocations, the actual outcome will depend on the number of firms and the degree of competition in both the supplying and purchasing industries, and on other variables such as demand elasticities. In many instances, the information would enhance a monopolist supplier's ability to engage in price discrimination and to exact monopoly returns with greater precision from disclosing firms.

Suppliers, like competitors, might also benefit from some nonfinancial data relating to market shares, the primary bases of competition and growth forecasts of their customers. In each case, the same can be said of informed vertical relationships as was said about informed horizontal relationships in the earlier subsection on competitors--disclosure, by promoting informed self-interested decision-making, amplifies the trends and condition of an imperfectly competitive marketplace.

CUSTOMERS AND CONSUMERS

The above analysis of the impact of detailed financial and market disclosure on suppliers is little changed for purchasers or companies immediately below the disclosing firm in the distribution chain. Where those firms wield market power and are price makers rather than price takers, disclosure can exacerbate market conditions.

In the case of consumers and purchasing firms that do not exercise market power, the most significant impact of disclosure does not flow from their own response to the information but as an indirect result of the decisions of competitors and suppliers. To the extent that an industry responds to market-related disclosures with invigorated competition and new entry, then consumers should ultimately stand to gain from lower prices and product improvements. Conversely, they could be made worse off where informed competitors pursued parallel practices or abandoned innovative activity.

When one turns to the realm of direct responses by consumers, the conditions which contributed to the success of disclosure in the securities setting appear to be present. There are numerous alternatives from which to choose, an uncomplicated purchasing decision to make and few adverse consequences which attach to the wrong decision, yet despite several consumer-oriented disclosure proposals which have been made in the United States,[94] there is relatively little of practical value to be gained from more extensive disclosure to consumers.

Additional information would have to compete with the abundance of data already supplied voluntarily through commercial advertising. To be absorbed by the consumer, the information would have to be communicated through channels which are notoriously costly. Merely keeping the data in a public file would not be sufficient because it is unreasonable to expect consumers of all but the more expensive articles to spend the time and effort searching registers, although the success of publications such as *Consumer Reports* does provide some evidence to the contrary.

A more fundamental problem with disclosure for consumers is deciding what information to make available. Line of business cost and profit figures don't play a part in most consumers' purchasing decisions. Only price and quality appear relevant; and of those the availability of price data appears ample. As for quality, disclosure at first light appears sound, for producers are in a better position than anyone else to know the characteristics of their product. Yet, as Stigler has commented, quality "has not yet been successfully specified by economists".[95] Does it include the fact that an article is hand made, union made or will enhance the purchaser's popularity with members of the opposite sex? To answer any one of the preceding questions with an obligation to disclosure poses serious problems of substituting one's personal biases for those of the consumer's and leads to the state's cultivation of tastes and interference with personal choice.

It may be safe to assume, however, that there is a core of consensus about some matters of product quality, such as those which relate to the consumer's health or safety. To this end, recommendations have been made in the United States that product test results ought to be disclosed or that information be made available on product composition.[96] It may well be desirable that such information also be relayed to Canadian consumers, assuming an efficient distribution method could be found and assuming that the costs and the potential for competitive harm to the disclosing corporation could be minimized. There are, however, several statutes such as the Hazardous Products Act[97] which presently deal with these specific issues of consumer protection. It would appear that these kinds of disclosures could be more productively discussed as part of the larger issue of the administration of these statutes rather than in the general context of corporate disclosure.

EXTERNALITIES AND SOCIAL COSTS

In an environment of increasing economic complexity, it is inevitable that some corporate activity will take place for which there is neither market nor suitable regulatory controls, thereby leaving those most affected without any means of influencing the activity. Where a corporation does not have to take the consequences and by-products of its activities into account, the cost of production becomes understated, which in turn leads to economic distortions in the allocation of resources.

Consider, for example, a textile mill which emits chemical wastes into a river, reducing the water's usefulness as a recreational facility and damaging the property of those downstream. Where the cost bearers and the cost causer come together to negotiate and place a value on the offensive activity, they internalize it to a market and the cost of compensating property owners becomes a cost of production. The solution would not

ordinarily eliminate pollution, unless the costs were so high as to cause the textile mill to install filters or to locate elsewhere; but it should lead to a socially optimal amount of pollution and an optimal allocation of resources.

Yet, market internalizing solutions are often impractical and rarely pursued because the logistics of identifying and bringing together large numbers of cost bearers and cost causers involves high transaction costs which substantially erode the benefits of any agreement. A contributing factor to such costs is the absence of information that cost bearers have about the identity of the cost causer and the nature of the cost causing activity. The firm responsible for the activity is in a better position than anyone to know what social costs it may be generating. In some instances, it may have prepared reports for government agencies or engaged in surveys of its own, or at least is in a position to make such surveys in the future. Whatever the source, the disclosure of data to cost sufferers would reduce transaction costs and could facilitate an informed market response which most resembled that of other suppliers to the productive process.

The possibility of reducing externalities by increasing the information flow has not attracted much attention as yet but it is not a subject best discussed in a vacuum. Rather it is an area for study and cautious experimentation, weighing such factors as the cost of disclosure, the extent of transaction costs unrelated to information, the type of cost causing activity, the availability of alternate regulatory methods, the number of cost sufferers and the availability of legal devices for the vindication of group rights.

IMPROVED DETERRENCE

Just as disclosure's effect on rational decision-making directs one's attention to the economic dimensions of corporate behaviour, the deterrent quality of disclosure highlights the social or political dimensions of that behaviour. As we noted in an earlier chapter, however, there are the preliminary problems in finding a consensus about what social and political standards of corporate behaviour the disclosure device should be used to reinforce. Few objections should be heard where that standard is expressed in legislation for in theory, at least, it is by definition popularly acceptable. Thus if Parliament imposed a duty on companies not to discriminate on the basis of sex in their hiring practices, an obligation to disclose information relating to those practices would serve as an aid to enforcement and would promote compliance with the duty not to discriminate. Some might object that such disclosure was too costly or perhaps demonstrate that it was unworkable but they could not oppose the preliminary issue of its legitimacy because that would call into question the legitimacy of a duty which Parliament had already prescribed. Once the right has been decided upon, only the appropriateness of the remedy remains for debate.

On the other hand, a bare obligation to disclose, or one which purports to reinforce a moral or popular standard can make no such claim to legitimacy. Yet, many of the claims for expanding disclosure in order to deter corporate behaviour are on just that footing. In the United States, various groups have recommended the disclosure of companies' political lobbying expenses, military research programs, involvement in South Africa, or contributions to foreign political officials.[98]

It may well be that a consensus of public opinion in the United States, or in Canada, would find these and similar issues sufficient cause for concern to warrant their disclosure in order to pressure corporate compliance with the social or political standards that each implies. In each case, the absence of legislation may not be conclusive evidence that a legitimating popular consensus does not exist; but one would have to be satisfied that such a consensus did in fact exist in order to justify a recommendation for these types of disclosures. Suffice it to say that the matter is one for the exercise of a political judgment which the Commission and not the writer is in a better position to make.

For those proposals for deterrent-based disclosures where legitimacy is not an issue on account of an existing legislated standard, it would be necessary to apply the analysis of Chapters 1 and 2 to determine whether disclosure might in fact be effective without encroaching excessively on the corporate interests set out in Chapter 3. Although little has been written in Canada, the American literature sets out several areas for this type of scrutiny including worker safety and product testing both of which were examined earlier.[99] Minority employment practices form the basis of several other recommendations for greater disclosure in the United States as do issues of environmental protection.[100]

It is not proposed to here discuss each of these issues in detail. Instead deterrent-based disclosure as a device for environmental protection will be selected simply as an analytical model in order to demonstrate the kind of considerations which ought to be weighed in determining whether to expand disclosure in these directions. The reader is then left to apply a similar analysis to other areas of deterrent disclosure.

Assume then that corporations would be required to provide the public with information concerning the discharge of particular effluents in excess of existing federal, provincial or municipal standards. If one looks to the quality of the information, the tests of accuracy and timeliness appear to be satisfied as we are dealing with finite measurable quantities for which the scientific community has developed both methods and equipment for proper and up to date accounting. Effluent levels may in fact be easier to accurately measure than profits. On the other

hand, the information is less comprehensible and its relevance more difficult to ascertain than most financial data; for few members of the community would appreciate and even fewer would commonly agree upon the significance of a shift in the parts per million of strange sounding substances such as polychlorinated biphenyl (PCB). In many instances the public would be assisted by the interpretive efforts of government officials or the press but this in turn presents a dilemma: the more accurate modes of measurement such as parts per million are the least comprehensible for the users of the information and therefore the least likely to be acted upon; yet, making the data more comprehensible detracts from its accuracy because common language explanations are subjective and judgmental. This problem would continue unless public agreement could be reached on some conventional and easily understood expressions which would communicate the seriousness of amounts in excess of standards and which would be correlative to parts per million figures.

Turning from the nature of the information to the purpose for which it is used, how effective would public disclosure be in dissuading firms from discharging effluents in excess of standards? It was noted in Chapter 1 that disclosure will only deter where there is a forum of public censure to which corporations regard themselves as responsible. There is little to satisfy that condition in the present context. The marketplace is no answer; for unless disclosure brings about a price increase through the internalization of social costs, the general public likely would ignore a firm's pollution record in purchasing its product. From a legal standpoint, the protection of the environment is entrusted to administrators, not to the public, and therefore the deterrent threat of civil actions by informed public litigants does not materialize. If administrators are the only persons with legal capacity to sanction excessive discharges, what marginal benefit would be gained from informing the public as well? One answer might be that public administrators are ultimately accountable to the public and it is not unreasonable to subject their activities to scrutiny and supervision. Public disclosure could thus be a stimulus for administrative diligence. It could increase the likelihood of enforcement and thus could have a positive effect on deterrence. Public suspicions could be eliminated and public confidence restored.

Are the incremental benefits to administrative diligence and the restoration of public confidence sufficiently beneficial to warrant such disclosure? What are the legitimate corporate interests that would be infringed? First, there is the issue of costs. Taking air and water samples, analysing them and disseminating the results can impose high costs which may be extremely burdensome for smaller firms. One could not recommend exemptive relief for such firms, however, since environmental impact unlike economic impact is not related to corporate size.

Where the information is already collected by the firms and reported to government, the initial expense will have been incurred and only the marginal costs of distributing the information to the public would remain, thereby substantially diminishing the importance of the cost factor; and where the sampling and testing is carried out by public officials, as it is in many jurisdictions, the cost would be negligible.

Second, there is a possibility that some effluent data might give competitors insight into a firm's production processes or the composition of its products and cause legitimate competitive harm through the appropriation of trade secrets. On the other hand, in industries where this could be done competitors might just as easily take the samples themselves as part of corporate surveillance. Presumably some chemical agent could be added by the disclosing firm to neutralize or camouflage the competitively significant elements of the discharge.

Third, and related to the previously discussed problem of making the information comprehensible to the general public, there is a possibility that environmental disclosures will invite a distorted public response. If a means can not be found for communicating the information in an everyday form, the public may either ignore the data or be subject to numerous "scares" by the few who purport to appreciate its significance. Well deserved corporate reputations could be irreparably damaged by the less responsible members of the press or scientific community who contend that the discharge of one, one hundred or one thousand parts per million of substance X constitutes an immediate danger to public health and safety. The problem is exacerbated for many substances by the lack of accord among reputable scientists as to what the actual effect might be; and the public might never be quite certain whether they were listening to a voice of providence in the wilderness or someone musing in the dark.

In the above example, and in each of the other areas for deterrent-based disclosure, the issues are complex, the variables are difficult to quantify and there is a need for the careful exercise of judgment.

5. ADMINISTRATIVE CONSIDERATIONS

The proposals canvassed in the preceding chapter on expanding the contents of the corporate information flow are important but they may not be as pressingly in need of attention as the administrative and procedural framework within which such substantive changes would be implemented. Viewed as a whole, Canadian corporate disclosure is fragmented and uneven in its application. Corporations must comply with the requirements of one or more of eleven jurisdictions and in each what, when and where to disclose may differ depending on a combination of factors such as the place of incorporation, the place where business is carried on, whether shares are publicly traded, where and how the shares are publicly traded, the company's size, the activities in which it is engaged and the entitlement to special exemptions granted by local courts and securities commissions. Moreover, the information which corporations must publicly disclose is only the tip of the iceberg. If one adds to this the mass of data solicited by federal and provincial governments for administrative, statistical and investigative purposes and then increases that figure by the number of uncoordinated data requests for the same information from different departments and agencies within the respective governments, the overall system of soliciting corporate information would confound the administrators of Byzantium.

For purposes of efficiency in administration, the same considerations apply to the collection of information for public disclosure as to the collection of information for internal government use, and the time may be near where it would prove sound to move toward one centralized and coordinated system for the collection of all corporate information irrespective of whether it would be distributed to the public. Computer technology is certainly up to the task, as the Quebec "Fichier Central", a comprehensive business register, indicates. The unevenness of the present system could be reduced as there would no longer be duplicate government requests for the same data nor any interjurisdictional loopholes or gaps.[101] Where disclosure was thought to be desirable it could simply be effected by providing public access to a central file at decentralized terminals where confidential data for internal government use could simply be "blinded out".[102]

A comprehensive corporate registry would be most effective at the federal level, but there are constitutional problems involved. Certain practical difficulties also arise, including the question of who should have the authority to fashion data requests which would be responsive to the varying needs of potential users both outside and between government departments.

A central registry may provide an appropriate topic for further study, but for present purposes discussion will hereafter be confined to the narrower issues of the adjustments that could be made to the present system of disclosure to reduce the unevenness of its application. Assuming that constitutional constraints preclude the creation at the federal level of a centralized disclosure authority for public and private, federal and provincial companies, the lack of consistency can best be reduced by centralizing authority within governments and by coordinating the policies between them.

As for intrajurisdictional inconsistency and the need to centralize disclosure authority within governments, disclosure is presently required by incorporating statutes, provincial securities legislation, corporate information acts and substantive legislation dealing with specific topics such as consumer protection or employment standards. Each statute theoretically requires the information for different purposes and each draws information from overlapping but different corporate populations.

In practical terms, however, there are essentially two distinguishing corporate characteristics that stand in the way of greater uniformity. The first is the distinction between public and private companies, which in England has been eliminated for disclosure purposes. As the discussion in Chapter 3 noted, the English lead is one which Canadian jurisdictions might well be advised to follow, for the manner in which shares are held has little to do with a corporation's economic and social impact. A far more relevant criterion, and one which has been adopted at the federal level in CALURA and the Canadian Business Corporations Act, is size; although one might have cause to question the seemingly high asset and revenue figures set by the latter statute.

The second distinction is based on territoriality. Companies that carry on business within a jurisdiction which is not the jurisdiction of their incorporation, nor one in which their securities are offered to the public, need only disclose very general identifying data. Their impact in social or economic terms, however, may be substantial and the fact that they are not subject to the same disclosure requirements places domestic firms at a disadvantage; and prompts claims for special exemptions under the corporations and securities acts. As the discussion in the preceding chapter indicated such special exemptions for "competitive disadvantage" contribute to uneven reporting and might well be abandoned on other grounds. The perceived need for them, however, would disappear, and their abandonment would be more palatable if disclosure was required of all competitors carrying on business within the jurisdiction.

There are problems, however, with extending the reach of disclosure in this way, one of which is constitutional. There are others as well, including the possibility of discouraging market entry and substantially adding to the amount of information which the disclosure system would have to handle.

Assuming the abandonment of distinctions based on share holding and territoriality would make it possible to iron out some of the unevenness in the intrajurisdictional disclosure requirements under incorporating statutes, securities legislation and general corporate information acts, there still remains the question of what information ought to be dealt with under more specific substantive statutes. The issue is perhaps most significant for deterrent-based social disclosure. One answer would be that for any information for which there is only one foreseeable class of user such as consumers or workers and for which the administrative supervision of a government department or agency is necessary to monitor compliance with legislated standards, disclosure requirements should emanate from that department or agency. On the other hand there is very little corporate information which has only one foreseeable class of users, for at a minimum shareholders and investors will usually be interested as well. Generally each case would have to be decided on its own merits taking into consideration the administrative benefits of centralizing the disclosure authority and the substantive benefits of departmental supervision.

As for coordinating disclosure requirements between jurisdictions, the provincial securities commissions have achieved some measure of success in this regard, with Ontario and the western provinces employing similar securities statutes and the provincial securities commissions agreeing on uniform policy statements. The trend towards interprovincial coordination in the securities field has increased in recent years and some commentators anticipate that further improvements are likely to result should the federal government enter the area.[103] The lack of coordination in securities regulation is still substantial. There are less encouraging signs for other areas of disclosure such as under the corporation acts and corporate information statutes.

Despite its importance for a fair and efficient scheme of corporate disclosure in Canada, interjurisdictional uniformity most likely falls outside the constitutional reach of a federal Royal Commission, and perhaps little more can be said save for a favourable passing comment that it is a goal to which a disclosure policy should aspire.

6. CONCLUSIONS

It is a common cliché that knowledge is power. At its best, disclosure is a decentralizer, a deconcentrator of such power and a condition precedent to accountability. Yet as the preceding chapters demonstrate, disclosure is an extremely complex legislative device. Its efficacy depends on a multitude of factors including the nature of the information, the context in which it is used and the segment of the public whose interests it is intended to advance, all of which must be weighed in the light of legitimate corporate interests for restricting disclosure and then measured against the availability of superior alternative legislative devices for effecting the same end.

NOTES

1. The Corporations Information Act, 1976, S.O. 1976 (Bill 136).

2. Canada Corporations Act, R.S.C. 1970, c. C-32.

3. Canada Business Corporations Act, S.C. 1974-75, c.33.

4. The annual return under the Canada Business Corporations Act is somewhat more detailed than the annual reporting requirements under most provincial statutes. For example, under the federal statute, a company's main types of business according to the Standard Industrial Classification must be set out. Quebec has recently amended its Companies Information Act infra 7 to include a similar requirement.

5. Corporations and Labour Unions Returns Act, R.S.C. 1970, c. C-31 (hereafter CALURA).

6. Quebec, Ministry of Financial Institutions, Companies and Cooperatives, (Le Fichier Central des Entreprises, 1974). By cross-indexing and computerization, and by designating each firm with a single identifying number, the government is able to assemble information in whatever combinations are at the time relevant to its needs.

7. Companies Information Act, R.S.Q. 1964, c.273.

8. The one major exception is CALURA, Part A, which has a specific focus on foreign ownership.

9. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKS USE IT, (1914), p.93. In the United States Disclosure to Investors: A Reappraisal of Administrative Policies Under the '33 and '34 Securities Acts, Report of the Disclosure Policy Study to the Securities and Exchange Commission, (1969) (hereafter cited as the "Wheat Report"), at page 51, this deterrent effect is referred to as the "housecleaning" quality.

10. U.S., Securities Exchange Act of 1934, 48 Stat. 881.

11. <u>Medical Committee for Human Rights v. S.E.C.</u> (1970), 432 F. 2d. 659 (D.C. Cir.); vacated as moot (1972) 92 Sup. Ct. 577. For a Canadian comment see ZIEGEL, CANADIAN COMPANY LAW, Vol. 2 (1973) and Getz, <u>The Structure of Shareholder Democracy</u>, 239 at 240-242.

12. U.S. Securities and Exchange Commission, Securities Act of 1933 Release No. 5386, required corporations to detail the material effect which compliance with environmental laws and regulations would have upon the corporation's financial conditions and set out any material litigation involving the corporation in relation to environmental protection. See <u>Natural Resources Defense Council Inc. v. S.E.C.</u> (1974) 389 F. Supp. 689.

13. The Securities and Exchange Commission has been moving towards expanding its requirements into areas which are seemingly distant from the capital market. It has been reported (<u>Wall Street Journal</u>, May 15, 1975, at 1 col. 6) that information has been requested on contracts and connections with the Defense Department and the Central Intelligence Agency.

14. <u>Blumberg, The Public's "Right to Know": Disclosure in the Major American Corporation</u>, (1973), 28 Bus. Law. 1025; Getz in ZIEGEL supra 11; Sommer <u>Random Thoughts on Disclosure as "Consumer" Protection</u>, (1972), 27 Bus. Law. 85.

15. BERLE AND MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY, (1932).

16. Stevenson, <u>Corporations and Social Responsibility: In Search of the Corporate Soul</u>, (1974) 42 Geo. Wash. L. Rev. 709 at 725 comments:

> Just as a vigorous and critical free press with access to the facts bearing on public decisions is one of our best guarantees of an effective, honest government, public access to information about corporate activities is a necessary condition for public opinion to influence corporate decision-making.

17. Blumberg, supra 14. The underlying problem with the notion of the "publicly" responsible corporation was best articulated over 40 years ago in Berle, For Whom Corporate Managers are Trustees: A Note (1932), 45 Harv. L. Rev. 1365 at 1367:

> Now I submit that you cannot abandon emphasis on 'the view that business corporations exist for the sole purpose of making profits for their stockholders' until such time as you are prepared to offer a clear and reasonably enforceable scheme of responsibilities to someone else.

18. Stevenson, supra 16.

19. Supra 12.

20. Stevenson, supra 16 begins his article with the quotation from BLACKSTONE, COMMENTARIES 477 (9th ed. 1783) that "Neither can a corporation be excommunicated; for it has no soul...."

21. Berle, supra 17 at 1369.

22. BENTHAM, OF LAWS IN GENERAL. ed. H.L.A. HART (U. of London, 1970).

23. Axelson, A Businessman's Views on Disclosure (1975); The Journal of Accountancy, July 1975, 42.

24. For an analysis of the changing concepts of the public interest in the United States see Stewart, the Reformation of American Administrative Law (1975), 88 Harv. L. Rev. 1669.

25. In this respect it is interesting to note that one of the most insightful discussions on disclosure appears in Canada, Report of the Royal Commission on Banking and Finance, 1964 (the Porter Commission Report). Although federally appointed, the Porter Commission considered the importance of disclosure to a healthy securities market.

26. This opposite jurisdictional mix should induce caution in those who are too readily prepared to duplicate U.S. measures.

27. Disclosure was well known to English and Canadian legislators prior to the U.S. Securities Acts. The American efforts were in part inspired by the prospectus provisions of the English Joint Stock Companies Act (1844) 7 & 8 Vict. c.110. Ontario companies legislation of 1907 (7 Edw. VIII, c.34, s.97) required that a prospectus be filed and delivered to prospective purchasers.

28. U.S., Securities Act of 1933, 48 Stat. 74.

29. U.S., Securities and Exchange Commission Act of 1934, 48 Stat 881.

30. LOSS, SECURITIES REGULATION (1961, 2nd. ed) 57.

31 Wheat Report supra 9 at 10.

32. Securities Act, R.S.O. 1970, c. 426.

33. Inter alia, where the purchaser is a bank or loan corporation purchasing for investment only (s.19 (1) 3); where a company distributes its own shares as a stock dividend (s.19(1)8i); or private placements (s. 19(3)).

34. Securities Act, R.S.O. 1970, c.426, s.41.

35. The authority to decide what constitutes a line of business is left to the company's directors. For a different system see the discussion infra at 90 ff.

36. Uniform Act Policy 2-12.

37. For example, Ontario, Interim Report of the Select Committee on Company Law, (1967); Ontario, Report of the Committee of the Ontario Securities Commission on the Problems of Disclosure Raised for Investors by Business Combinations and Private Placements (1970); ZIEGEL, CANADIAN COMPANY LAW, Vol. 2, and Emerson, An Integrated Disclosure System for Ontario Securities Legislation, 439.

38. The original version was introduced as Bill 154 in 1972, then revised and introduced in 1974 as Bill 75, and revised and introduced once again as Bill 98 in 1975. The Bill is to be introduced once more in early 1977.

39. Canada Business Corporations Act, S.C. 1974-75, c.33, s.186.

40. Joint Stock Companies Act (1844), 7 & 8 Vict., c.110.

41. Supra 15.

42. Getz, in ZIEGEL supra 11; Blumberg supra 14.

43. CARY, CORPORATIONS (1969, 4th. ed.) 304.

44. Canada Business Corporations Act, S.C. 1974-75, c.33, s.147(1)(a).

45. Canada Business Corporations Regulations, (1975), SOR 75-682, s.35(jj).

46. Blumberg, supra 14 at 1026, quotes McGeorge Bundy, President of the Ford Foundation, as stating in an address to the Investment Company Institute, Washington D.C. on May 19, 1972 that:

> ...we believe, in general, that proposals for disclosure should be supported except when they involve an area where confidentiality is reasonable for reasons relating to fair competition or legitimate personal privacy.

47. Benston, Evaluation of the Securities Exchange Act of 1934, (1974) Financial Executive, May, 1974, 28. At page 31, Benston comments that S.E.C. mandated disclosures "either are completely discounted by the market before they are published or do not predict the economic future. In either case the data are not useful to investors at the time the S.E.C. requires disclosure".

48. Bray, Financial Disclosure and Accounting Practice, (1968), L.S.U.C. Lectures, Developments in Company Law, 251 at 257; Birkett, True and Fair--The Law and Accounting, (1968) The Australian Lawyer 97; BUCKLEY AND LIGHTNER, ACCOUNTING:AN INFORMATION SYSTEMS APPROACH (1973). A more cynical, albeit colourful, commentary appears in BARNETT AND MULLER, GLOBAL REACH (1975) at 263 where the authors refer to accountants as "the space age alchemists" who "have discovered the incantations that turn banks into nonbanks, dividends into interest and profits into losses". They go on to note that "skilled obfuscation is now an essential accounting tool".

49. SKINNER, ACCOUNTING PRINCIPLES, (1972) 297.

50. Idem at 33; Nelson, The Case for Decent Disclosure, (1975), C.A. Magazine, March, 1975, 35 and text supra at 24.

51. Kripke, A Search for Meaningful Securities Disclosure Policy (1975), 31 Bus. Law. 293 at 315. See also Kripke, The Myth of the Informed Layman (1973), 28 Bus. Law. 631.

52. Idem; See the panel discussion reproduced at (1973) 28 Bus. Law 505.

53. Nelson, supra 50 at 38; Arrow, infra 57; Economic Council of Canada, infra 57.

54. Panel Discussion supra 52 and the comment of Marsh at 524 to 531, Axelson supra 23.

55. Bray, supra 48.

56. The Business Corporation Act, R.S.O. 1970, c.53 s.173 (3).

57. The study of the economics of information is of recent origin, and does not date back much farther than the last decade. Some of the principal works are: Alchian, Information Costs, Pricing, and Resource Unemployment, 7 Western Economic Journal 109 (1969): Arrow, Information and Economic Behaviour, United States Office of Naval Research Contract N00014-67-A-0298-0019, Project NR 047-004 on Reserve at Littauer Library, Kennedy School of Government, Cambridge, Massachusetts; Demsetz, Information and Efficiency: Another Viewpoint, 12 J. of Law & Econ. I (1969): Stigler, The Economics of Information, 69 J. Pol. Econ. 213 (1961). See also Economic Council of Canada, Report on Intellectual and Industrial Property (1971).

58. HAVEMAN AND MARGOLIS, PUBLIC EXPENDITURES AND POLICY ANALYSIS, (1970) Zeckhauser, Uncertainty and the Need for Collective Action, 96 at 113; Arrow, supra 57 at 12.

59. The term "non-rival" is used in MUSGRAVE AND MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE (1973). The term "inexhaustible" is derived from the Note in 77 Harvard Law Review 888 infra at 62. Whichever expression is used, the concept is that, unlike chocolate chip cookies, no matter how much information one gives away or consumes he will not have less than he started with.

60. Zeckhauser in PUBLIC EXPENDITURES AND POLICY ANALYSIS, supra 58.

61. The costs of communicating information, however, are not independent of output nor are the initial costs of assembling or compiling it.

62. 77 Harv. L. Rev. 888, (1964) at 932.

63. In return for the grant of monopoly, the public should benefit from the introduction of new products and new ideas. The knowledge is then available to anyone who cares to enter the patent office: it is only the right to exploit the knowledge that is the subject of the grant of monopoly.

64. Arrow, supra 57.

65. Some innovative activity would take place even if protection from this kind of competitive harm were not available. The list of such situations would include those where the innovator had a substantial head start on a difficult to duplicate discovery with high short-run profit potential; or where the innovator was motivated not by reward but by the instinct of contrivance, or where all firms in an industry expend large amounts on research and development expenditures.

66. Canada Business Corporations Act, S.C. 1974-75, c.33, s. 154(3).

67. Canada Corporations Act, R.S.C. 1970, c. C-43, s. 129.3(1).

68. Securities Act, R.S.O. 1970, c.426, s. 132(1).

69. Re Niagara Wire Weaving Co. Ltd. [1971] 3 O.R. 633. (C.A).

70. Idem per Kelly, J.A., at 640.

71. Re Firth Brown Steels Ltd. [1972] 3 O.R. 66(C.A).

72. Re St. Lawrence Starch Co. Ltd. [1972] 1. O.R. 293 (H.C)

73. Loss, supra 30 at 829.

74. Johnston, Exemption From Sales Disclosure in Regular Financial Statements; Courts, Tribunals and Business Judgments, 24 U. of Toronto L.J. 215.

75. Idem at 222. Johnston notes a trend at the O.S.C. towards a "less generous exempting disposition". This does not appear to have rubbed off on the Ontario Court of Appeal. See for example Re Armco Canada Ltd. and Minister of Department of Consumer and Corporate Affairs, (1976) 8 O.R (2d) 741.

76. Canada Business Corporations Act, S.C., 1974-75, c.33 s. 15(1).

77. See generally Canada, Privacy and Computers, A Report of a Task Force Established Jointly by the Department of Communications and the Department of Justice (1972): Canada, Conference on Computers: Privacy and Freedom of Information, Telecommission Study 5(6) (1970): Ontario, Protection of Privacy in Ontario, Ontario Law Reform Commission (1968).

78. Idem.

79. WESTIN, PRIVACY AND FREEDOM (1967).

80. Idem at 42.

81. Freund, Privacy: One Concept or Many, Nomos XIII (1971)

82. Canada, Report of the Task Force on the Structure of Canadian Industry (1968).

83. Canada, Foreign Direct Investment in Canada (1972).

84. There is a curious inconsistency in both the Watkins and Gray reports in that the notion of Sovereign Will would not seem to be an adequate basis for inquiry into foreign investment by corporations created by the "Will" of a foreign sovereign.

85. Zeckhauser supra 58 notes:

> The neoclassical model of perfect competition requires perfect knowledge: there can be no uncertainty. The presence of uncertainty, a lack of knowledge of which state will obtain in the future, makes the model inoperative.

86. For comments on the competitive importance of information see generally U.S. Federal Trade Commission Staff Report, Economic Report on Corporate Mergers (1969), and the articles referred to in 57 supra.

87. American Column and Lumber Co. v. United States (1921) 257 U.S. 377.

88. Canada Business Corporations Regulations (1975), SOR 75-682, s.48.

89. The Business Corporations Act, R.S.O. 1970, c.53, s. 178(3) 18.

90. NADER GREEN AND SELIGMAN, CONSTITUTIONALIZING THE CORPORATION: THE CASE FOR FEDERAL CHARTERING OF GIANT CORPORATIONS (1976); NADER AND GREEN (eds) CORPORATE POWER IN AMERICA, (1973); Mueller, Corporate Secrecy vs. Corporate Disclosure 113; F.T.C. Staff Report supra 86; Donald Turner, Testimony before U.S. Senate Antitrust Monopoly Subcommittee February 5, 1970, 91st. Congress 2d. Sess.

91. U.S., Federal Trade Commission, Annual Line-of-Business Report, Initial Release, March 27, 1974. The best commentary on F.T.C. line-of-business reporting is Bock Line-of-Business Reporting; Problems in the Formulation of a Data Program Research Report of The Conference Board No. 654, (1974). See also Benston, The Baffling New Numbers Game at the FTC (1975), Fortune, October, 1975, 174.

92. U.S. Federal Trade Commission Bureau of Economics Staff, Proposed Revision of From LB Supporting Statement, April 12, 1975, p.1.

93. As contained in Securities Exchange Act Releases of the S.E.C. under U.S., Securities Exchange Act of 1934, 48 Stat. 881, s. 13(a).

94. NADER AND GREEN supra 90; NADER supra 90: Note, Minding the Corporate Conscience, Economic Priorities Report, Vols. 1-5 (1970-1975).

95. Stigler supra 57 at 224.

96. Supra 94.

97. Hazardous Products Act, R.S.C. 1970, c.H-3.

98. Supra 94.

99. Idem; Blumberg supra 14.

100. Idem.

101. Supra 6. For the problems of complying with the government data requests in the U.S. see Hyatt, Strangling in Red Tape, Wall Street Journal, October 13, 1975 p. 8.

102. Wheat Report supra 9, Watkins Report supra 82.

103. The Canada Business Corporations Act does contain a substantial number of "securities type" provisions. A great many articles and reports have commented on the need for uniformity and co-ordination including the Porter Report supra 25. The most insightful discussion of the interrelationship of provincial and federal efforts at uniformity appear in Baillie, Securities Regulation in the 'Seventies' in ZIEGEL supra 11, 343 at 385 ff.

APPENDIX

Disclosure from a Broader Perspective: Government Information Management and Freedom of Information

As noted in the introduction, corporate accountability to the public has traditionally flowed through government, and it has been to government alone that corporate information has been relayed. Government, in fact is the single largest user of corporate information. However, the way in which the federal government has organized and discharged this information function is a cause for substantial concern. Two fundamental problems can be seen. First, the highly decentralized and unco-ordinated systems of collecting and managing information have created duplications and gaps in the store of information on hand. This has resulted not only in unnecessary public expenditures, but has also over-burdened corporations with the costs of having to respond to redundant requests for similar information from different government departments. Second, the information systems are overly secretive, concealing not only corporate activity but, more importantly, government activity, from public visibility and accountability. In this respect corporations are more responsible to their constituents, the shareholders, than is the government to its constituents, the public.

To give either of these issues adequate consideration would require a study larger than the preceding one. Therefore, what follows is intended to be no more than a brief overview of the federal information systems, their efficiency and the scope of public access.

The Three Major Information Systems

In addition to administering such public disclosure statutes as CALURA Part A or the annual return requirements of the Canada Business Corporations Act, the federal government uses three principle systems of internal information management - investigative, statistical, and administrative - each of which is distinctive for the manner in which information is acquired, stored and disseminated.

(1) The Investigative System

Several government agencies such as the R.C.M.P. or the Combines Investigations Branch of the Department of Consumer and Corporate Affairs maintain intelligence files on various corporations as part of their job of enforcing the criminal law. Unlike the collection of statistical or other information for which the subject company completes a form and is thus responsible for the reliability of the information on file, investigative information is unique in that it is compiled by enforcement personnel from surveillence, seizure or the questioning of third parties.

To make investigative information available to the public would jeopardize the integrity of a law enforcement system dependent on the security of unidentified sources and the concealment of ongoing investigations. Confidentiality also protects private parties where the details of a criminal investigation could be so controversial and damaging that due process considerations warrant the verification of such information by a court or other appropriate forum first before making it available to the public.

Administratively, the collection and management of investigative information is not formally co-ordinated between one federal body and another, and although informal co-operation is common, duplicate parallel investigations do occur.

(ii) The Statistics System

The essential quality of the statistics systems is that the identity of the source of the information is concealed by a process of aggregation and averaging, with the result that no one, including government administrators, can relate the published statistics to any individual person or company. The Statistics Act in fact makes the disclosure of identifying data a criminal offence.

The census provides the most familiar example of the statistics system in operation. From it, one may learn the average age of unemployed warehousemen in Winnipeg but not anything that could identify them such as their names or social insurance numbers. Of greater relevance to the corporate setting is the statistical processing of CALURA Part B and corporate tax returns.

The statistics function manifests the highest degree of co-ordination within the federal government's information structure. Its management and direction are not left to the government department most interested in using the information but are entrusted to a single specialized body - Statistics Canada, an agency which has developed considerable expertise in the employment of modern technology and specialized skills in data collection and processing.

iii) The Administrative System

The majority of information collected by government is neither investigative nor statistical but consists of administrative material collected by government departments for use in policy making and program implementation. These files are also not generally available to the public, but not on account of any statutory proscription such as section 16 of the Statistics Act, but because the federal government has taken the position that confidentiality is essential to the parliamentary system if notions of ministerial responsibility and public service anonymity are to have meaning. In theory, only Cabinet Ministers

and not civil servants have the authority to provide information to Parliament and the public. In practice this has meant that secrecy is the rule and publicity the exception.

From an organizational standpoint, the most distinctive feature of the administrative information system is decentralized data collection and management. Each department determines the information it will need and sets about independently collecting it. Although Ministers can authorize interdepartmental data transfers or shared-cost collection efforts and although some deference is given to prior screening of data requests by the Treasury Board, several factors work against the realization of administrative efficiency which such practices could occasion - from technical problems of incompatible filing methods to departmental concerns for compromised autonomy.

Observations on the Management of Government Information

A responsive and effective government requires reliable up-to-date information. As the role of government expands its need for information expands as well. This in turn puts pressure on the existing methods of collecting and processing information. In fact, one can attribute many of the current problems with the management of government information to the simple fact that existing structures are feeling the weight of the tremendously expanded role of government over the past few decades.

One way to solve the inefficiencies of duplication in information management would be to regard them only as symptoms of inefficient duplicated divisions of government authority. The symptoms and the problem would disappear upon a government reorganization of departmental powers. Yet that is perhaps too ambitious. A second solution would be to retain the existing divisions of authority but completely centralize the collection and storage of information in a single agency, thereby reducing collection costs and lessening the paperwork burden for corporations. That solution, however could cause more problems than it solves. It would lead to the acquisition of information unsuited to the needs of those who would us it and substantially erode departmental autonomy. Extending the jurisdiction of Statistics Canada for this purpose would be inappropriate because that agency is only expert in handling a special kind of data - statistics, the usefulness of which is limited given the requisite absence of identifying detail. What is needed is a system with that degree of centralization of information collection and processing that would optimize efficiency through the reduction of duplication while preserving sufficient departmental authority to be responsive to departmental needs for reliable and up-to-date information. Unfortunately this approach is more a statement of an ideal than a practical alternative, because the appropriate trade-off point between centralization and decentralization will differ dramatically

depending on the type of information and the scope and nature of its intended use.

All the foregoing alternatives involve major substantive and jurisdictional long term changes in government structures. Of more immediate interest however are some essentially procedural steps which can and should be taken. The Quebec Fichier Central or central business register approach referred to in the body of the paper, or a similar system, should be adopted. It offers a skeletal structure for classifying and organizing corporate data and provides a base upon which other information systems can be built. Second, standards should be promulgated which would ensure that the filing systems of different government departments would be sufficiently compatible for exchange and transfer of information. Such standards are particularly important as more government records become computerized and as computers are devised with the ability to work "across" files by selecting and presenting data in forms and combinations which would require separate collection efforts. Third, consideration should also be given to a low profile screening agency which co-ordinated and filtered all requests from statistical or administrative agencies in order to eliminate duplicate collection activity. At the risk of some encroachment on departmental autonomy, the screening body could even be empowered to entertain submissions by corporations, provincial governments and members of the public to implement, repeal or amend any particular information request.

Observations on Public Access and Freedom of Information

There is no public access to government information in Canada. The facts upon which government decisions are based can not be known except to the extent and in the manner that the government chooses to make them known. The basic principle is that everything is secret unless specifically disclosed. In recent years pressures have been building to reverse that principle and to adopt the approach of the United States and Sweden where information in government files is open to the public unless specifically exempted from disclosure.

Although freedom of information legislation in the United States operates within a different government structure and within a different political climate, its principle of openness in government ought to be embodied in similar Canadian legislation. Such legislation however, need not overlook the unique demands of our parliamentary system of government.

Greater public access to information would pave the way to making government decision-makers more accountable to the public and to corporations for the way in which corporate activities are regulated and controlled. Greater public access would quickly

bring to light government error and would equip the public and the press with the knowledge necessary for constructive public debate.

The public right to access to corporate information in government files should not be unqualified. As with the United States freedom of information legislation, there would have to be exemptions from disclosure. To this end the reasons for limiting corporate disclosure set out in Cahpter III of the paper are equally applicable as guides for the release of corporate information from government files. The potential for competitive harm and the possible invasion of corporate privacy should be grounds for exempting information from public access. One would also want to safeguard the personal privacy of employees and others.

Further exemptions could be granted for investigative data and for much of the information presently processed by the statistics system. However, in keeping with the thrust of freedom of information legislation, the role of Statistics Canada to collect and process corporate information should be reassessed and, where appropriate, cut back. The highly secretive statistics system has been employed where confidentiality has simply not been warranted. Part B of CALURA is one example. Some have suggested that the tax returns of large public companies may be another. In any event, the potentially overreaching jurisdiction of Statistics Canada warrants reassessment.

The real debate over freedom of information legislation however is likely to focus on the mechanics of public access. Should the courts have the power to determine the scope and application of exemptions? How many days should the government have to respond to a request for information? Should the corporation about which information is being requested be notified of the request and be given the opportunity to oppose it? Who should bear the cost of searching for and copying information? Should documents be freely translated into both official languages?

The questions are not easy to resolve but freedom of information legislation is right in principle and should be enacted. The mechanics will simply have to be worked out.